OVERSIGHT HEARINGS ON EMPLOYEE BENEFIT PLANS

HEARINGS

BEFORE THE

COMMITTEE ON EDUCATION AND LABOR
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

HEARING BEFORE THE FULL COMMITTEE HELD IN WASHINGTON, DC,
MARCH 21, 1985

HEARINGS BEFORE THE SUBCOMMITTEE ON LABOR-MANAGEMENT
RELATIONS HELD IN WASHINGTON, DC, APRIL 2 AND 3, 1985

Serial No. 99-114

Printed for the use of the Committee on Education and Labor

U.S. GOVERNMENT PRINTING OFFICE
48-903 O WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

H341-93

COMMITTEE ON EDUCATION AND LABOR

AUGUSTUS F. HAWKINS, California, *Chairman*

WILLIAM D. FORD, Michigan
JOSEPH M. GAYDOS, Pennsylvania
WILLIAM (BILL) CLAY, Missouri
MARIO BIAGGI, New York
AUSTIN J. MURPHY, Pennsylvania
DALE E. KILDEE, Michigan
PAT WILLIAMS, Montana
MATTHEW G. MARTINEZ, California
MAJOR R. OWENS, New York
RICK BOUCHER, Virginia
CHARLES A. HAYES, Illinois
CARL C. PERKINS, Kentucky
TERRY L. BRUCE, Illinois
STEPHEN J. SOLARZ, New York
MERVYN M. DYMALLY, California
DENNIS E. ECKART, Ohio
TIMOTHY J. PENNY, Minnesota
CHESTER G. ATKINS, Massachusetts

JAMES M. JEFFORDS, Vermont
WILLIAM F. GOODLING, Pennsylvania
E. THOMAS COLEMAN, Missouri
THOMAS E. PETRI, Wisconsin
MARGE ROUKEMA, New Jersey
STEVE GUNDERSON, Wisconsin
STEVE BARTLETT, Texas
ROD CHANDLER, Washington
THOMAS J. TAUKE, Iowa
JOHN R. McKERNAN, Jr., Maine
RICHARD K. ARMEY, Texas
HARRIS W. FAWELL, Illinois
PAUL B. HENRY, Michigan

SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS

WILLIAM (BILL) CLAY, Missouri, *Chairman*

WILLIAM D. FORD, Michigan
DALE E. KILDEE, Michigan
MARIO BIAGGI, New York
CHARLES A. HAYES, Illinois
MERVYN M. DYMALLY, California
CHESTER G. ATKINS, Massachusetts
MAJOR R. OWENS, New York
AUGUSTUS F. HAWKINS, California
(Ex Officio)

MARGE ROUKEMA, New Jersey
ROD CHANDLER, Washington
RICHARD K. ARMEY, Texas
STEVE BARTLETT, Texas
HARRIS W. FAWELL, Illinois
JAMES M. JEFFORDS, Vermont
(Ex Officio)

CONTENTS

Hearings held in Washington, DC: Page

March 21, 1985 ... 1
April 2, 1985 ... 31
April 3, 1985 ... 289

Statement of:

Erlenborn, John N., partner, Seyfarth, Shaw, Fairweather & Geraldson, and former ranking member, Committee on Education and Labor ... 290
Fay, Richard H., partner, Reed, Smith, Shaw & McClay, representing the U.S. Chamber of Commerce; Robert Krinsky, president, Martin E. Segal Co., representing the Association of Private Pension and Welfare Plans; and Robert D. Lebenson, president, American Society of Pension Actuaries ... 456
Friedman, Karen, Women's Pension Project; Jack Guildroy, member, National Legislative Council, American Association of Retired Persons; and Karen Ferguson, director, Pension Rights Center ... 426
Futrell, Mary Hatwood, president, National Education Association, accompanied by Linda Tarr-Whelan, director, division of government relations; and William Welsh, director of legislation, American Federation of State, County, and Municipal Employees, accompanied by Charles M. Loveless, legislative representative ... 354
Georgine, Robert, chairman, National Coordinating Committee on Multiemployer Plans ... 178
Hoffman, William S., director, Social Security Department, United Auto Workers, accompanied by Alan Reuther, associate general counsel; and S. Howard Kline, United Steelworkers of America ... 244
Kirkland, Lane, president, American Federation of Labor and Congress of Industrial Organizations, accompanied by Raymond Denison, director, legislative department, AFL-CIO; and Rudolph Oswald, director of research, AFL-CIO ... 4
Lebed, Hartzel Z., president of CIGNA Corp., representing the American Council of Life Insurance and the Health Insurance Association of America; Robert S. Stone, senior corporate counsel, IBM, representing the ERISA Industry Committee; and George Cowles, senior vice president, Bankers Trust, representing the American Bankers Association ... 262
Myers, Robert J., former Chief Actuary, Social Security Administration, and Emily Andrews, research director, Employee Benefit Research Institute ... 302
Ross, Stanford G., partner, Arnold & Porter, former Commissioner, Social Security Administration; Robert A.G. Monks, former Administrator, Office of Pension and Welfare Benefit Programs, U.S. Department of Labor; Donald S. Grubbs, Jr., George B. Buck Consulting Actuaries, Inc.; and Lisle C. Carter, Jr., partner, Verner, Liipfert, Bernhard, McPherson & Hand, chartered, former member, President's Commission on Pension Policy ... 41
Roukema, Hon. Marge, a Representative in Congress from the State of New Jersey ... 32

Prepared statements, letters, supplemental materials, et cetera:

Alliance of American Insurers, statement of ... 506
American Academy of Actuaries, statement for the record ... 509

American Federation of State, County & Municipal Employees [AFSCME]:

"Effect of Possible Changes in Employee Benefit Tax Policy on State and Local Government Employees" report entitled ... 535

Page

Prepared statements, letters, supplemental materials, et cetera—Continued
  American Federation of State, County & Municipal Employees [AFSCME]—Continued
    "Employee Benefits: Too Taxing?" Independent Study Shows "Adverse Impact" article from AFSCME News, dated May 10, 1985 531
    "Employee Benefits: Too Taxing?" (table) 534
  American Medical Association, statement of with attachment 649
  Anchor National Life Insurance Co., statement by 652
  Andrews, Emily S., research director, Employee Benefit Research Institute [EBRI]:
    Oral statement 312
    "Pension Coverage Broad—But Not Among Small Firms," article from EBRI News, dated April 3, 1985 345
    Summary of statement 321
  Bailey, William G., CIC, president, National Association of Professional Insurance Agents, prepared statement of 826
  Bartlett, Dwight K., III, president, Mutual of America Life Insurance Co., prepared statement of 814
  Blue Cross and Blue Shield Association, statement of 663
  Bomba, John L., D.D.S., president, American Dental Association, Washington, DC, letter to Chairman Clay, dated April 23, 1985 with attachment 519
  Carter, Lisle C., Jr., Verner, Liipfert, Bernhard, McPherson & Hand, former member, President's Commission on Pension Policy:
    Letter to Chairman Clay, dated April 24, 1985 enclosing requested information 167
    Prepared statement of 164
  Chandler, Hon. Rod, a Representative in Congress from the State of Washington, opening statement of 33
  Committee of Annuity Insurers, statement of 677
  Cowles, George W., the American Bankers Association, prepared statement on behalf of 282
  Erlenborn, John N., partner, Seyfarth, Shaw, Fairweather & Geraldson, Washington, DC, prepared statement of 293
  Fay, Richard H., Reed, Smith, Shaw & McClay, statement on behalf of Chamber of Commerce of the United States, prepared statement of 457
  Ferguson, Karen, director, Pension Rights Center, prepared statement of.. 453
  Fornaro, Dominic N., commissioner of labor and industry, State of Maryland, letter to Hon. William Clay, dated June 13, 1985 873
  Friedman, Karen, Women's Pension Project:
    Prepared statement of 444
    "The Case of the Disappearing Pension," booklet entitled 428
  Futrell, Mary Hatwood, president, National Education Association, prepared statement of 356
  Georgine, Robert A., chairman, National Coordinating Committee for Multiemployer Plans, Washington, DC:
    Prepared statement of 181
  Grubbs, Donald S., Jr., F.S.A., consulting actuary, George B. Buck Consulting Actuaries, Inc., "Vesting, Portability and Integration With Social Security Under Private Pension Plans," article entitled 113
  Guildroy, Jack, National Legislative Council, American Association of Retired Persons, Washington, DC, prepared statement of 448
  Heinz, Hon. John, a U.S. Senator in Congress from the State of Pennsylvania, prepared statement of 39
  Hewitt Associates, "Survey of Plan Design and Experience in 401(k) Salary Reduction Plans," survey entitled 684
  Hoffman, William S., Ph.D., director, Social Security Department, International Union, UAW, Prepared statement of 246
  Institute of Electrical and Electronics Engineers, Inc., Washington, DC, statement supporting pension reform 725
  Investment Co. Institute, Washington, DC:
    "IRA's Add Billions to New Savings, But Potential Still Untapped," article from News Release, dated February 28, 1985 732
    "IRA's: The People's Choice," Booklet entitled 737
  Javits, Jacob, a former U.S. Senator from the State of New York, letter to Chairman Clay enclosing a statement 177

Page

Prepared statements, letters, supplemental materials, et cetera—Continued
  Kline, S., Howard, United Steelworkers of America:
    Prepared statement of Lynn R. Williams, president, United Steelworkers of America, presented by 256
    "Retirement Income Security," article from Steelworkers Legislative Newsletter, dated April 2, 1985 256
  Krinsky, Robert D. president, Martin E. Segal Co. on behalf of Association of Private Pension and Welfare Plans, prepared statement of 461
  Lebed, Hartzel Z., president, CIGNA Corp., on behalf of the American Council of Life Insurance and the Health Insurance Association of America, prepared statement of 264
  Lebenson, Robert D., president, American Society of Pension Actuaries:
    Commentary on November 1984 Treasury Tax Proposals Affecting the Private Pension System 477
    Discussion of material to be covered in verbal testimony 467
    Pension Reform Legislation, Discussion Outline 479
    Prepared statement of 466
    Social Security Integration and Vesting Rules for Qualified Retirement Plans, a discussion outline 485
    Summary Policy Statement Regarding the Private Pension System 471
    The Answers to a Dozen Important Questions About the Private Pension System 473
  Monks, Robert A.G., former Administrator, Office of Pension and Welfare Benefit Plans, Department of Labor:
    Prepared statement of 47
    "Summary of Conclusions From Hearings," summary entitled 54
  Myers, Robert J., former chief actuary, Social Security Administration, prepared statement of 305
  NAGLO Resolution, ERISA Amendment, submitted by John C. Brooks, commissioner of labor, State of North Carolina 875
  National Pension Forum, Washington, DC:
    Introduction to report 189
    Letters of support 227
    National Pension Forum participants (a list) 190
    Recommendations for Action by Secretary Donovan 200
  Older Women's League, Washington, DC, statement of 830
  Profit Sharing Council of America, Chicago, IL, statement of 838
  Rawson, W. Randall, director of government affairs, American Chiropractic Association, Washington, DC, letter to Chairman Clay, dated April 24, 1985 517
  Ross, Stanford G., former Commissioner of Social Security, prepared statement of 42
  Roukema, Hon. Marge, a Representative in Congress from the State of New Jersey, opening statement of 34
  Roybal, Hon. Edward R., a Representative in Congress from the State of California:
    Letter to Chairman Clay, dated April 3, 1985 35
    Prepared statement of 36
  Stone, Robert S. (senior counsel, IBM), chairman, the ERISA Industry Committee [ERIC], prepared statement of 277
  Swain, Frank S., Chief Counsel for Advocacy, U.S. Small Business Administration, Washington, DC, letter to Chairman Clay, dated April 24, 1985, enclosing a statement 844
  Tobleman, Ronald W., F.S.A., Rudd & Wisdom, Inc., consulting actuaries, Austin, TX, letter to Chairman Clay, dated May 2, 1985 842
  Weber, Hon. Vin, a Representative in Congress from the State of Minnesota, letter to Chairman Clay, dated April 1, 1985, enclosing several letters from Minnesota constitutents 852
  Weinhaus, Sheldon, Levin & Weinhaus, St. Louis, MO, letter to Chairman Clay, dated March 28, 1985 with several enclosures 800
  Welsh, William B., director of legislation, the American Federation of State, County & Municipal Employees, AFL-CIO, Washington DC, prepared statement of with attachments 363
  Williams, Lynn R., president, United Steelworkers of America, prepared statement of 256
  Women's Equity Action League, Washington, DC:
    "Earnings Sharing: Equity and Adequacy for Women Under Social Security," article from WEAL Facts 869
    Testimony by 861

OVERSIGHT HEARINGS O
PLA

THURSDAY, MA

HOUSE
COMMITTEE O

The committee met, pursuant to
Rayburn House Office Building, Ho
man of the committee) presiding.

Members present: Representat
Murphy, Kildee, Martinez, Owens,
Solarz, Dymally, Eckart, Penny, A
son, Chandler, McKernan, Armey,

Chairman HAWKINS. The Commi
called to order.

Today we begin a series of hearin
began with a full committee hear
tance we attach to pensions and e
ers and their families. The hearing
by the Subcommittee on Labor-M
chaired by our colleague, William C

Ten years ago last fall, the Cong
ee Retirement Income Security A
measure in the Rose Garden on La
acting that legislation explicitly r
size and number of benefit plans, t
and their importance to the conti
millions of employees and their de
ly found them to be affected with
important to the stability of emplo
velopment of industrial relations.
unique private sector character of t
courage them to make them equita

Now, at another time, in another
and many in the Congress seem t
and they are looking desperately fo
nues, to reduce expenditures, or
have begun to focus on the resourc
ee benefit plans, on payments of w
ployment compensation, as if they
mined for Federal revenue. The ta
partment and some in the Congress
providing fringe benefits. That

N EMPLOYEE BENEFIT
NS

RCH 21, 1985

OF REPRESENTATIVES,
N EDUCATION AND LABOR,
Washington, DC.

call, at 10 a.m., in room 2175,
n. Augustus F. Hawkins (chair-

ives Hawkins, Clay, Biaggi,
Boucher, Hayes, Perkins, Bruce,
tkins, Petri, Roukema, Gunder-
Fawell, and Henry.
ttee on Education and Labor is

gs on employment benefits. We
ing to demonstrate the impor-
nployee benefit plans for work-
s will be continued next month
anagement Relations which is
lay.
ress passed ERISA, the Employ-
ct. President Ford signed that
bor Day 1974. The Congress en-
ecognized the growth in scope,
heir social and economic impact,
nued well-being and security of
pendents. The Congress explicit-
the national public interest and
yment and to the successful de-
The Congress recognized the
hese plans and undertook to en-
ble and effective.
atmosphere, the administration
be mesmerized by the deficit,
r opportunities to increase reve-
oth. In their desperation, they
es of pension plans and employ-
orkers compensation and unem-
vere newly discovered gold to be
x theorists in the Treasury De-
characterize these programs as
haracterization, they seem to

think, puts employee benefit plans in a class with tax shelter gimmicks and frivolous perks, the social and economic equivalent of the three-martini lunch and, therefore, fair game for some rate-flattening, base-broadening reform.

We do not agree. It is not enough to focus merely on the revenue implications. It will be the purpose of this committee to ensure consideration of the social and economic objectives of these programs. Pensions, health insurance, day care and education programs, workers compensation and unemployment insurance form a life support system for working people, a system unique in this country, one provided in other nations of the world by government. It is important, before we leap to any tax revenue conclusions, that we reexamine our national policy toward these important benefits with a view to reaching sound policy decisions.

Before calling on the witness, the Chair would like to ask any of the members who may—Mrs. Roukema, would you wish to make a statement? If so, the Chair will yield to you at this time.

Mrs. Roukema. I want to thank you, Mr. Chairman, for holding these hearings today to initiate a series of oversight hearings on employee benefits and the need for a national retirement income policy.

I am pleased that we have such a distinguished guest, Mr. Kirkland, and hopefully your presence today will draw attention to the very crucial problems we face in the retirement income policy area.

As the ranking Republican on the Labor-Management Relations Subcommittee, I met at the very beginning of this session to discuss with Chairman Clay what our subcommittee agenda should be, and I was gratified to learn that we both have the same item at the top of our agenda, a thorough examination of our retirement income system and the need, if any, for legislation establishing a national retirement income policy.

ERISA is now 10 years old. It is generally agreed that it has served a vital purpose in protecting those employees who are covered by pension plans to ensure that their expectations are met. But don't misunderstand, ERISA is not perfect, and we all have our views as to how it could be improved. But when one considers that the number of defined benefit plans has doubled, with an even larger increase in defined contribution plans, one can only conclude that we are certainly in much better shape than we were 10 years ago.

What we must consider now is whether there is a need to go further in strengthening the third leg of the three-legged retirement stool, Social Security, individual savings and private pensions. On these rest our hopes for maintaining adequate income for those who have retired. Each leg has its own problems. However, with the pension leg, we generally find that, for those who participate, this system is working well. The largest problem is with those who are not participating. This can result from many things: working for employers who do not have pension plans, or frequent shifts in employment, and extended breaks in service, and so forth.

Hopefully, from these hearings which we are beginning today, we will learn more about the nature of the problem and what can be done about it. Meanwhile, we recognize that our private retirement system is a voluntary one, so we must be careful not to create disincentives for employer participation.

It is a difficult assignment, but I am happy to be working with Mr. Clay and the chairman of the committee.

Chairman HAWKINS. Thank you, Mrs. Roukema.

Mrs. ROUKEMA. Thank you, Mr. Chairman.

Chairman HAWKINS. Mr. Clay, chairman of the Subcommittee on Labor-Management Relations.

Mr. CLAY. Thank you, Mr. Chairman.

It is indeed a pleasure to have Mr. Kirkland before the committee today. I look forward as well to his testimony.

Today begins a series of hearings that the Labor-Management Relations Subcommittee has been planning for a long time. More than 10 years ago, Congress took an important step forward by enacting ERISA which established basic protections for employee pension and other benefit plans. While ERISA was a historic plan, we continue to lack a comprehensive policy regarding retirement income and other benefits.

In recent years, we have seen sporadic and haphazard changes in the law affecting employee benefits. Each time the initiative has been carried out with no broad policy considerations in mind beyond raising revenues. The narrow focus of the recent changes and others that are currently proposed have obscured their all important effect on securing these benefits and pensions. The time has come to take a broad look at these issues, and that is why we have initiated these hearings.

Today's hearing will focus on the role of employee benefits, while the subcommittee hearings that follow will focus more specifically on retirement income policy. It is appropriate that we begin our considerations with a close examination of all of these benefits. Largely as a result of the Treasury's tax proposals, employee benefits are under attack with little or no public consideration. This administration has proposed taxing those benefits which would greatly increase their costs.

Let there be no mistake about it. Although the current attack on employee benefits comes dressed as tax reform, the issue is one that directly affects labor-management relations. In part as a result of tax incentives, more than a third of a typical worker's earnings today is in the form of deferred compensation. For many years, we have encouraged employers to anticipate the future needs of workers through the establishment of employee benefit plans. Tax incentives have clearly influenced labor relations policies in this area. The demand for many of the programs within the jurisdiction of the Education and Labor Committee is significantly influenced by the degree to which such services are provided. The need for Government-sponsored day care programs, for example, clearly depends on the extent to which an employer provides child care.

In light of the administration's infatuation with the role of the private sector in taking over traditional governmental functions, I find it most difficult to understand the reasoning behind slashing employer incentives to provide employee benefits. Massive cuts in publicly provided social programs, and now the proposed price increases in employer provided services, are counterproductive. The same administration which purports to be a champion of the private sector is frustrating its ability to take the pressure off of publicly-provided services.

Retirement income policy and employee benefits are both labor-management relations and ERISA issues that fall squarely within the concern of the Labor-Management Relations Subcommittee. It is for that reason that we have placed these issues at the top of our subcommittee agenda. It is also clear that cuts in employee benefits may affect many of the programs within the jurisdiction of the full Education and Labor Committee, which is why we have decided to initiate our consideration of these issues at the full committee level. As these hearings continue at the subcommittee level, we are determined to broaden the focus. We intend to provide a forum to explore the questions that should be asked about retirement income policy and employee benefits. Only then can we hope to arrive at an understanding of what is at stake and how we might formulate sensible reforms.

Thank you, Mr. Chairman.

Chairman **Hawkins**. Thank you.

The witness today is Mr. Lane Kirkland, president of the American Federation of Labor and Congress of Industrial Organizations. Mr. Kirkland, the Chair certainly wishes to thank you for getting so many of the members to the committee today so that the Chair will become better acquainted with some of the members of the committee. [Laughter.]

I hope that I can call on you on other occasions when we have some difficulties. [Laughter.]

There are two important activities, one on one side to discuss the MX missile, and on the other side the Democrats having regional conferences to discuss ways of attacking the budget. So this is indeed a tribute to you that we were able to collect as many members as we did, who otherwise are very devoted to their duties, I can assure you anyway.

Without any other introduction, may we then call upon you to present your views as you see fit.

STATEMENT OF LANE KIRKLAND, PRESIDENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS, ACCOMPANIED BY RAYMOND DENISON, DIRECTOR, LEGISLATIVE DEPARTMENT, AFL-CIO; AND RUDOLPH OSWALD, DIRECTOR OF RESEARCH, AFL-CIO

Mr. **Kirkland**. Thank you very much, Mr. Chairman.

My name is Lane Kirkland, and I am president of the AFL-CIO. With me today is Ray Denison, director of the legislative department; and Rudy Oswald, director of our department of research.

On behalf of the AFL-CIO, I am grateful to this committee for providing the proper forum in which to discuss some of the implications of the proposal to tax employee benefits. While the idea has been raised ostensibly as a tax and budget issue, it is primarily an issue of basic national social policy in which this committee has jurisdiction, interest, and competence.

Beginning a century ago in imperial Germany, and universally since World War II, the industrial nations of the world have looked upon health care, education, retirement security and life, disability, and unemployment insurance as fundamental necessities of a stable, progressive society.

Tacitly or explicitly, these countries have perceived that the national interest requires constantly rising minimum standards in each of these areas, and most have dealt with them through government programs financed through general revenues. In all of the countries that have chosen this path, such programs have been endorsed, maintained, and expanded by successive governments, liberal and conservative alike.

The United States has chosen a different path. Instead of adopting a direct and universal life-support system, the Congress chose to try to meet these needs primarily through the Tax Code, by encouraging the untaxed diversion of a part of each worker's wage or salary earnings programs and other programs specified by the Congress from time to time to meet perceived social needs, such as child care and prepaid group legal services.

The success of this social policy is testified to by the fact that 140 million people now have job-related health care insurance protection in the United States. Thus, this is not a tax incentive that has benefited only a small powerful minority or a narrow special interest lobby.

This network of protection was created under the leadership of the American trade union movement, through the institution of collective bargaining, but it has long since become deeply embedded in the Nation's whole employment structure, not the least in the nonunion and antiunion companies that hope, by offering generous benefit programs, to dissuade their employees from organizing.

It would be hard to overstate the role of this life-support network in developing the Nation's economy. Its protection has given millions the sense of security and confidence to enter the marketplace and undertake commitments for long-term mortgages, college tuition loans, time-purchase agreements for cars, and durable goods of all kinds. Lenders are no less strongly influenced than borrowers by the presence or absence of these protective programs. America needs more, not fewer, of these personal life-support programs.

Until the late 1940's, working people and their families lived with the constant fear that illness or disability would mean dispossession and impoverishment as well. Such is still often the case if the job-related life-support system is disrupted by unemployment, as we saw in the recent recession. To many families whose breadwinner was laid off or fired, the loss of health care insurance coverage proved a greater blow than the loss of the job itself. Some found that even a short hospital stay wiped out all of their savings. Others, without insurance or cash in hand, were stopped at the hospital door and sent to public health facilities, putting a heavy strain on public resources.

With the experiences of the recent recession freshly in mind, Congress ought to be considering ways to strengthen the private life-support system rather than devising new taxes to undermine it.

The attack on employee benefit programs is taking place at a time of huge and deepening Federal deficits. But the tax treatment of benefits is not the source of this crisis. The attempt to raise revenues by taxing workers' benefits and reducing their standard of living is patently unfair. Even after accounting for tax increases enacted later, three-fourths of the deficit is directly attributable to the 1981 tax laws which lavished huge and uncalled for depreciation writeoffs on the Nation's business, while giving vastly disproportionate personal tax cuts to upper-income classes. The revenue shortfall should not be met by levying additional burdens on working people and adding to the unfairness that has characterized economic policies of the past several years.

Taxing workers' life-support benefits has been a part of this administration's agenda since its earliest days. Health insurance, accident and life insurance, unemployment compensation, workers' compensation, day care, education programs, group prepaid legal plans—even pensions—are all on the hit list. The Bradley-Gephardt fair tax plan, it should be noted, also would tax employee benefits.

The administration and others who would tax benefits seek to justify this effort with the notion of equal treatment of similarly situated taxpayers. This would make some sense if applied to preferences and abuses motivated by tax avoidance with few, if any, redeeming features. Unfairness is epitomized by such abuses as expense account living, country club membership, and other questionable preferences that discriminate in favor of those at the top. Such practices have no social purpose, and certainly should not be encouraged by the Tax Code.

In contrast, the employee benefit programs under attack are not frivolous perks or gimmicks to shelter income. They don't generate phony losses or otherwise reduce the taxes of the privileged, but are widely distributed in the national interest.

It is unfair that all workers do not benefit by an adequate medical program, pension protection, life insurance, and other benefits. But such inequities should be resolved through public and private policies that encourage a leveling up of benefits, not by policies that seek to reduce everyone to the lowest common denominator. Such a narrow view of equity ignores the far greater inequity that would result from a lowering of benefits and fewer participants. That viewpoint also implies that tax justice means merely rearranging the tax burdens of working people.

To qualify for tax exclusion now, benefit plans must comply with stringent rules that prohibit discrimination in favor of owners, officers, shareholders and highly compensated employees, and generally contain limitations and constraints to assure that the intended beneficiaries and purposes are served. That test clearly distinguishes these provisions from so many other so-called tax preferences which primarily benefit a privileged few and provide no assurance that any national purpose will be served.

Far more important, if tax fairness is a concern, is the equity that could be achieved through closing the many loopholes and distortions in the Tax Code that now heap the burden of taxation on working people as a group and tread only lightly on corporations, wealthy stockholders, investors and speculators.

Those who would tax employee benefits also like to link the growth in benefits to the Tax Code as if workers and employers were conspiring to raid the Treasury. But a review of the origin, growth, and structure of workers' benefits destroys this notion.

A recent Library of Congress study of employee benefits discusses the many reasons for their growth and underscores their social purpose. Among other things, the study points out that as living standards rise, workers rightly become more concerned about the economic consequences of death, illness or unemployment, and give up wages and other improvements to gain security through essential protections. Employee benefit programs also generated economies of scale that reduce cost. The effects of benefits in reducing worker turnover and promoting employment stability, as well as the role of unions in raising the level of benefits, are highlighted. The study notes that unionized firms have an average of 30 percent higher levels of benefits than comparable nonunion firms.

The analysis also points out that even with the dramatic increases of benefits in the post-World War II era, ". . . the relative level of U.S. fringe benefits still remains a smaller part of total compensation than it is in most other industrialized nations."

In exempting health insurance contributions from taxation, the Congress has promoted private health coverage and lessened the need for a comprehensive public health program. Subjecting such health contributions to taxation would inevitably undermine private coverage and require a greater direct public role and increased expenditures for the provision of health care.

The administration's proposal to place a monthly limit of $175 per family and $70 per individual on the amount of tax-free contributions that employers make to worker health insurance plans would dismantle the safety net of employment group health insurance. These health care policies cover union members and nonunion workers without regard to sex, health status or type of employment. If the administration's proposal passed, millions of families would be forced by economic necessity to avoid paying higher taxes by giving up their protection against the high cost of getting sick. A recent Roper survey disclosed most employers would move to reduce benefits.

If tax benefits for health care contributions were to be scaled back, most likely to be dropped from a benefit plan are coverage for preventive care, outpatient diagnostic services, dental, eyeglasses and other benefits that affect premium costs but have little to do with the health cost inflation problems that plague the Nation, primarily in doctor and hospital fees.

In advocating the employee health tax, the administration would have citizens believe that health care is a costless fringe to workers. In fact, tough economic decisions are made and other benefits, including wages, are sacrificed to preserve and enhance the health care benefit package. All of us are extremely sensitive to the rising costs of health care services and, in collective bargaining, increasingly have had to make difficult decisions in the absence of comprehensive cost containment legislation to reduce the rate of growth in total health care costs. This has obviously resulted in a growth in health insurance benefits relative to wages and salaries. The rising expenditure on medical care has increased from 3.2 percent of GNP in 1953 to 7.2 percent in 1983. This rise reflects greater citizen use of medical care, the increasing quality and availability of treatments, and the rapid increase in the cost of medical care. Increased costs and usage have little relationship to the fact that employee medical benefit plans are not taxed. In fact, there has been a rise in the number of plans that require employees to pay a portion of the health insurance costs, an occurrence in direct conflict with the notion that the tax exemption has caused the increased use.

The administration also has claimed that health insurance benefits are unnecessary subsidies for higher wage workers. The AFL–CIO strongly rejects this position. Employers contribute the same amount for health coverage per employee, regardless of income. As a result, health benefits as a percent of income are more valuable to families at lower wage levels. Limiting tax-free contributions would, therefore, place a disproportionate burden on middle and lower income workers who would find it much more difficult to maintain their level of benefits.

The next step is obvious. The young, the single and the poor, if given the opportunity, would be inclined to opt out of their plans. Those left would be those who can afford the higher costs and those who are older and more in need of frequent health care services. This, in turn, will cause the premiums of the plan to go up, raising taxes further.

Another erroneous assumption the administration has made about the employee health tax is that workers in very few industries actually would be affected by the proposed implementation of the plan. An informal AFL–CIO survey of a number of international unions completely refutes this position. According to the Machinists, a majority of the union's members would be forced to pay taxes on their health benefits. The vast majority of Autoworkers, Steelworkers, and members of the Electrical Workers, as well as the Electronics Workers, also would be affected. The Service Employees union reports that about half of all SEIU members would be hurt. It is estimated that 60 percent of the membership of the State, County, and Municipal Employees would fall above the cap. For the United Food and Commercial Workers, the average contribution to health benefits in the union's largest agreement amounts to $250 per family, $75 per month above the proposed limit. It is clear that a broad range of AFL–CIO families would be penalized by the Treasury plan.

Not to be ignored is the wide fluctuation of health care costs among geographic areas. For example, health benefit contributions for members of the Electrical Workers range from an average of $1 per hour in Oklahoma and Texas to as high as $2.40 per hour in California and approximately $1.75 per hour in New Jersey. Obviously, the tax would disproportionately penalize workers in the highest cost areas.

Without question, the most mean-spirited aspect of the administration's proposals to tax life-support benefits involves the heaping of further burdens on those suffering the loss of employment and the pain of work-related injury, disease, and even death. Taxing the meager benefits provided under unemployment insurance or workers' compensation adds to the injustice for those workers who have experienced the indignity of job loss or the tragedy of injury or disability stemming from the workplace.

Unemployment insurance benefits, which average only $119 per week across the Nation, are already subject to taxation if income exceeds $18,000 for married taxpayers and $12,000 for singles. The Treasury proposal would tax all UI benefits. In 1980, the National Commission on Unemployment Compensation, comprising of representatives of employers, workers, and the public, recommended the repeal of current provisions under which a portion of UI income is taxes. In its report to the President and the Congress the Commission said:

> UI is the first line of defense against extreme hardship caused by unemployment. When a person is unemployed, the family's income stream is already reduced even if UI is being received. To subject this family's reduced income stream to income taxation adds to the unemployed person's sense of injury already caused by the loss of a job.

Just as devastating is the suggestion by the administration to tax all workers' compensation benefits. At most, workers' compensation replaces two-thirds of lost wages. Caps and ceilings in many cases mean even less protection. The 1972 National Commission on Workmen's Compensation Laws concluded that, in general, inadequate benefit levels and inequitable treatment existed in all States. The 1979 report of the Interdepartmental Workers' Compensation Task Force found that, by the most conservative standards, workers' compensation cash benefits to impaired workers were seriously inadequate. In the face of these authoritative studies, the Treasury now wants to make a bad situation immeasurably worse by taxing these benefits and further widening the gap between net income levels and what is necessary to maintain decent living standards.

The first $50,000 of employer-provided group term life insurance is also excluded from tax under present law and would be taxed by the Treasury and other proposals.

Again, the limitation in current law prevents discrimination and abuse. Those who do receive relatively high benefits are already taxed as a result of the $50,000 maximum, and to the extent that the legislation has resulted in a cost to the Treasury, the protection afforded those who need it the most is certainly in the national interest.

Group legal services plans would no longer be tax exempt under the Treasury proposals. The current tax treatment of qualified group legal service plans has helped in making such services available at minimum cost to many who would otherwise be denied such protection. There is no evidence that such plans have been abused or exploited as tax shelters or have led to inequities or discriminatory practices. The Treasury proposes to allow this program to expire on December 31 this year.

Stringent limits also preclude abuse in dependent care services, another benefit plan in jeopardy. Any revenue gain would be minimal, and it is clearly of the national interest to encourage the growth and development of such programs.

Also, Congress was wrong last year in allowing the expiration of the statutory exclusion from income of benefits provided employees and laid-off workers under an educational assistance program. Fortunately, the program was reenacted for 1 more year. Again, there is no evidence of abuse, and the limitations and conditions needed to quality assure against unintended benefits or actions contrary to congressional intent. And programs under these plans have helped employees and laid-off workers receive essential training. However, unless Congress reenacts this protection, this protection, too, will expire on December 31 of this year.

While the proposals at hand do not attempt to tax employees immediately on the deferred income value of employer contributions to qualified pension plans, we know they were considered and set aside temporarily. But this subject would raise a huge array of issues. First, of course, is the fact that pension income is taxed when received by the employees and their beneficiaries. To qualify, plans must comply with elaborate minimum participation standards and other rules that forbid contributions or benefits discriminating in favor of the employer's officers, shareholders, and other highly compensated employees.

The interest in taxing employer contributions to worker's pension plans is particularly difficult to understand in the light of the many recent attempts and actions to widen the exclusions for individual retirement accounts and to expand plans for the self-employed. These measures contain few of the constraints and assurances against abuse that apply to qualified employee pension plans and have a record of reducing the tax burdens of wealthier individuals while doing little or nothing to add to the Nation's savings rate.

In conclusion, I would again like to commend this committee for holding these hearings on employee benefits. These life-support benefits are an important part of our Nation's social policy and must not be relegated to the narrow confines of the Tax Code. Therefore, it is particularly gratifying that this committee is conducting this investigation.

Four decades ago, few of America's working people enjoyed these benefits. Today, because of such factors as the decisions of the Congress, court decisions, collective bargaining, and the higher wages that have allowed workers to devote more of their income to health and welfare, a large portion of both union and nonunion workers receive a variety of life-support benefits. The intent of Congress was clearly to promote the spread of these programs.

Largely because of the revenue shortfall created by the unfair and revenue-eroding Tax Act passed in 1981, these programs are being eyed as a source of new tax receipts. Nearly three-fourths of the deficit is directly attributable to the unfair revenue giveaways enacted in 1981. The Nation can best resolve the deficit by reversing some of the real inequities in the Tax Code, not by levying additional burdens on working people.

The AFL-CIO strongly urges the members of this committee to resist the proposals to penalize workers and retard privately financed programs that promote social improvement and the well-being of the American people.

Thank you, Mr. Chairman.

Chairman **Hawkins**. Thank you, Mr. Kirkland, for a very clear and concise treatment of the subject. The Chair would certainly like to commend you on behalf of the committee for the presentation you have made to us today.

In yielding to the members, may we let you know that, because of the size of the committee today, we will strictly enforce the 5-minute limitation so as to allow as many members as possible to have an opportunity to question the witness. The Chair, having used its 5 minutes already, will begin yielding to the other members. Mr. Clay, do you have a question?

Mr. CLAY. Briefly, Mr. Chairman. Thank you.

I have one question. Mr. Kirkland, in April, the Subcommittee on Labor-Management Relations will be holding hearings on the need for a national retirement income policy. If we had such a policy, the needs of workers and their families would be the central issue that must be considered each time a legislative proposal, such as taxing employee benefits is advanced. A two part question: No. 1, do you agree that we need such a policy; and No. 2, in terms of an overall national policy, does taxing benefits across-the-board make any sense?

Mr. KIRKLAND. I certainly agree, sir, that we need a policy and, hopefully, that policy would be one to which I could subscribe. And I expect that we shall have something to say about that. Clearly, the issue of the tax treatment of these plans is a crucial part of the question.

Mr. CLAY. Thank you.

Thank you, Mr. Chairman.

Chairman HAWKINS. Thank you.

Mr. Petri.

Mr. PETRI. Thank you, Mr. Chairman.

I have a whole series of questions, but first I wanted to ask Mr. Kirkland if he would at all care to comment on a major change in the labor area in this administration, the appointment of Mr. Brock as Secretary of Labor. Do you feel that he is a man you can work with, and what are your reactions to his appointment?

Mr. KIRKLAND. I have stated, Mr. Congressman, at the time that he was appointed yesterday, my views. I indicated that we welcomed that appointment, that we had worked with Bill Brock in a number of areas of concern to us and to working people, that we had found him accessible, informed and thoughtful, that although we did not always agree, that we did have disagreements on policy issues, that he had earned our respect and that we looked forward to a new and a more constructive relationship with the Department of Labor and hoped that his appointment will strengthen that Department and, hopefully, restore it as a significant instrument for the advancement of the well-being of working people.

Mr. PETRI. Thank you.

I have a question in connection with your testimony on the treatment of fringe benefits in the Treasury Department tax proposal. As you know dozens or hundreds of groups are coming in and arguing that this feature or that feature is bad and unfair and, yet, if you look at the overall proposal, the Treasury Department argues that it would, in fact, lower the total tax burden on individuals by $20 billion to $30 billion, raise it on corporations and, in fact, would benefit those earning $50,000 or less most and would lower the tax burden on working people.

So in Congress we have to look at the pluses and the minuses, and I wonder if you would feel that overall it is a good proposal for working people relative to past tax proposals or a bad proposal for working people?

Mr. KIRKLAND. We have indicated that there are aspects of that mysterious package that was not embraced by anybody but floated—I am not sure as to whose package it is. But there were aspects of that package with which we could agree. There are others with which we would be in strong disagreement. We are expressing our disagreement on this particular aspect.

But some long experience has suggested to me that time to examine the net out of tax legislation is probably along about midnight when the conference committee produces its masterwork, and the resolution of the importunities of the various forces of work becomes a little bit clearer than it is today.

Mr. PETRI. Thank you.

Chairman HAWKINS. Thank you, Mr. Petri.

Mr. Biaggi.

Mr. BIAGGI. Mr. Kirkland, given the fact that we are trying to develop a national retirement policy, it would seem to me that there should be some special effort made to retain the older worker in the job. You say in your testimony that taxing employee health benefits would most seriously impact upon young people and would force them to drop out of the workforce. Do you feel it would have the same effect on the older worker?

Mr. KIRKLAND. I think that the point we are trying to make is that the usage rate of health insurance plans tends to be higher for older workers. It is higher for workers with families. Therefore—and the same is true as is the case with pension plans. Obviously, the closer you get to retirement, the more important this seems to you.

Imposing taxes would have a very, very significant effect on the elements of choice. And those workers who conceive themselves as in less than immediate need of health care protection would be those most likely to withdraw or to opt in favor of taking the cost in cash in the wages. The result would be—this insurance parlance, I think, is described as adverse selection. And adverse selection would in itself drive up the cost of providing this coverage to the detriment of all concerned.

Mr. BIAGGI. Mr. Kirkland, this committee and this Congress over the years have provided the kind of tax exemption to these benefits that we now enjoy. What do you see as a consequence if these tax exemptions were repealed?

Mr. KIRKLAND. Well, clearly, logic tells me that if the tax exemption is motivated and served to encourage the growth of these plans, it would strengthen the economy, strengthen our society; the imposition of taxes would discourage that growth and lead to their shrinkage, which would be contrary to the best interests of the country at large, the best interests of a strong society.

Mr. BIAGGI. If I recall correctly, oftentimes when labor negotiated with management, the thrust was toward benefits as a substitute for increases, or at least it balanced off. Now if this tax benefit, tax exemption, is repealed, could we foresee the thrust now going to additional wage increases?

Mr. KIRKLAND. The effects, I think, would be manifold. All of them can't be clearly predicted. I think we must bear in mind they will all have unintended consequences. I can foresee a number of consequences. One, of course, is the disruption of harmonious collective-bargaining relationships because the net out of the agreements that have been reached in the past and would be negotiated in the future would change quite drastically. It would throw a monkey wrench into sound collective bargaining. It would lead to strong pressures for reopening existing agreements. It would have a tendency to divide and create friction within the membership and within the work forces as different age groups, family groups, saw theirselves impacted differently and make different judgments on the matter. And since the collective-bargaining process does reflect the will of the membership, I can only see the most negative results from it.

Mr. BIAGGI. Thank you, Mr. Kirkland.

Thank you, Mr. Chairman.

Chairman HAWKINS. Mrs. Roukema.

Mrs. ROUKEMA. Thank you, Mr. Chairman.

I would again reiterate our interest, Mr. Clay's and mine, in seeking to work with your organization on a national retirement income policy.

Mr. Chairman, in the interest of time, I would like to ask if I could submit a question for Mr. Kirkland's response concerning the problems of women and highly mobile and sporadic workers in general in terms of retirement income. I would like to submit that to you for a written response for our record.

Chairman HAWKINS. Without objection, so ordered. Mr. Kirkland, you will respond to the committee on that.

Mr. KIRKLAND. Yes.

Mrs. ROUKEMA. We will send it to you, Mr. Kirkland.

Mr. KIRKLAND. Please do.

Mrs. ROUKEMA. In addition, carrying on with the thrust of your testimony, which has to do with the taxing of benefits, I think it should be pointed out and restated, as you did earlier in your testimony, that this is not just a Treasury or administration plan, this has been taken up philosophically as part of what seems to be a developing national consensus on fair tax policy. The Bradley-Gephardt tax, as you indicated, is a Democratic proposal that tries to get at the same thing, and includes the same provisions.

Now without making a brief either for the Democratic proposal or the Republican proposal, the consensus is a growing one——

Mr. KIRKLAND. I assure our position on this is nonpartisan as well.

Mrs. ROUKEMA. Quite correct. I am glad to see that the AFL-CIO, the NAM, and the chamber of commerce are all in agreement in their opposition to taxing these benefits.

But I want to see how you answer the question, which is the philosophical underpinning for this national consensus, and that is that we want a neutral tax system. What about those workers who do not enjoy the fringe benefits, either because they are self-employed or because their employers do not afford all the range of benefits? They are paying taxes on their income and also paying out of pocket for the benefits that other workers enjoy untaxed. How do you respond to that?

Mr. KIRKLAND. I think that is unfair. I think the remedy is encourage the extension of these plans to those who are not now covered.

Mrs. ROUKEMA. How do you do that for the self-employed?

Mr. KIRKLAND. Through collective bargaining and by not taxing them. Taxing them would further enhance that unfairness by increasing the number of people who are not covered, and I don't think that is fair.

Mrs. ROUKEMA. And you give no credence at all to the benefits for reduced tax rates for your workers?

Mr. KIRKLAND. Yes, I do. We can put together a fair package to achieve that end that would not include this proposal.

Mrs. ROUKEMA. How could you define "fair," as opposed to this proposal?

Mr. KIRKLAND. One that continues the tax exemption of these benefits.

Mrs. ROUKEMA. And then increase the opportunities for tax exemption for the self-employed as well as the other workers who do not presently enjoy them.

Mr. KIRKLAND. We have put forward year after year rather comprehensive proposals that would simplify and make more equitable the tax system of this country. We thoroughly agree that the present system is inequitable, is excessively complicated and burdensome, and riddled with inequities. We have addressed this year after year after year. During the first year of the present administration, when the President made a statement saying those who don't like the tax and budget proposals he put forward—he challenged anyone who didn't agree to come up with a better alternative. We took him up on it, and we would be delighted to provide this committee with our alternative tax and budget proposals of 1981, of 1982 and of 1983. The net effect of our proposals would have reduced the deficit and would have led to a fairer, more equitable and a simpler tax system.

Mrs. ROUKEMA. Thank you, Mr. Chairman.

Chairman HAWKINS. Thank you.

Mr. Murphy.

Mr. MURPHY. Thank you, Mr. Chairman.

Mr. Kirkland, thank you for being with us and giving us the value of your experience and your advice this morning.

I just have one question to ask you. As you know, we are quite active in our Steel Caucus and other caucuses here on the Hill in the problems of international trade. Is it my understanding that the ratio of fringe benefits for the American worker is lower than that of our industrialized neighbors?

Mr. KIRKLAND. That is quite clearly the case, sir.

Mr. MURPHY. Is that the case? Then it would seem as though doing anything or reforming or taxing the fringe benefits would certainly give us no competitive edge with international trade.

Mr. KIRKLAND. No, sir. In fact, the fact that our fringe benefit costs are lower than those of our trading competitors offsets to some degree whatever other competitive edges they may enjoy. There is no factor in that comparison that would argue for this type of measure on the basis of international trade concerns. The fact is—most people don't realize it—the United States of America continues to have one of the harshest systems in the world, among the industrial democracies, as far as working people are concerned.

Mr. **Murphy**. Harshest in what respect?

Mr. **Kirkland**. In most countries in Europe, if a person is unemployed, he never really goes off of benefits. They continue in one form or another almost perpetually, as compared to what happens in this country where he can be fired by the hour and have a limited scale of benefits for a very limited period of time, and you lose your health insurance coverage with it.

Mr. **Murphy**. We have experienced a great deal of that.

Mr. **Kirkland**. You may lose your home, you may lose your health and all this protection. That does not happen in European countries.

Mr. **Murphy**. How about in Asia?

Mr. **Kirkland**. It does not happen in Japan. I am speaking of the industrial democracies.

Mr. **Murphy**. Industrial democracies, yes.

Mr. **Kirkland**. The ones that are supposed to be proud of the way they treat their people.

Mr. **Murphy**. Have you made any effort to convince the administration that they would be wiser to attempt health cost containment rather than taxing premiums or health benefits?

Mr. **Kirkland**. Yes, we have, and that is a point that we have been arguing for some time. The problem of soaring medical costs is, I think, a critical one. It has yet to be effectively addressed, except by proposals such as this that curtail access to medical care or to limit the degree of coverage that is afforded. The problem does not stem from these plans, the problem stems from other factors. And we have put forward many proposals, both legislative and in terms of our relationships with employers.

We addressed this question, for example, over a period of time with the labor-management group that has been meeting regularly for some years, and this is one area where we reached a degree of agreement, substantial agreement, with the employer community represented there, and developed approaches to work together in our respective communities to deal jointly with the medical service provider community in the effort to do something about these runaway costs. And it is this element that I think makes this kind of a proposal even add to the unfairness of it.

In recent years, negotiations on health insurance issues between our affiliates and management have not produced improved benefits. They have been concerned with the coverage—of paying for increased costs without improved benefits, to keep the same benefits. These increases in costs with no improvement in the benefits and no improvement in the coverage and no improvement in access to medical care would, in themselves, lead to higher taxes, making it doubly unfair, and that is another travesty of this kind of approach.

It is, of course, commonly known that these costs vary quite tremendously from one part of the country to other. Living in one part of the country would increase your taxes without any difference in the real benefits that are——

Mr. **Murphy**. I am glad you pointed that out in your testimony. I thought that was a very good point, particularly in the higher cost areas. Thank you very much, Mr. Kirkland.

Chairman **Hawkins**. Thank you.

Mr. Chandler.

Mr. **Chandler**. Thank you, Mr. Chairman.

Mr. Kirkland, I think you made a good point on page 6 of your testimony when you say increased costs and usage have little relationship to the fact that employee medical benefit plans are not taxed. I agree with that statement.

The American Medical Association proposed the idea believing that a threshold, above which there was taxation, would reduce usage. I disagree with that as well.

However, I wonder what your opinion would be if we went to the other end and began to deal with the low side of it, since you point out that this rise reflects a greater citizen use of medical care? One of the things I wonder about is if we could get people to stop going to the doctor with a runny nose or to the emergency room on Sunday night with a sore throat, if that would have a great deal to do with the reduction in the costs, especially to these employee health benefit plans.

What would you think of the idea that, instead of taxing above a certain level, having some requirement for a qualification of plans that would have a person paying for either the direct costs of the health care or their own insurance with aftertax dollars for that early part—in other words, some deductible in order to qualify for the tax benefit?

Mr. **Kirkland**. I think that that would aggravate the problem, sir, rather than solve it. The solution to the rising costs, the runaway costs, in medical care is not the trip to the doctor with a runny nose or to the emergency center with a sore throat. That is not the area of runaway costs. The area of runaway costs is hospital care and the hospital treatment, something that is dictated by the judgment of the physician not the patient. In fact, attempts to move in that direction and approach it from that end would have, in our opinion, a contrary result, because it would discourage one of the more promising ways and effective ways to reduce—the costs of acute illnesses or acute conditions is in the preventive area which is heavily dependent upon early diagnosis and early treatment.

Chairman **Hawkins**. You may have another minute.

Mr. **Chandler**. The statement, though, you make is the rise in the expenditure on medical care is a four-point difference between those 30 years, between 1953 and 1983. And your first point is a greater citizen use of medical care is an element in that rise. I agree with that statement. Anytime you have insurance——

Mr. **Kirkland**. It is not the use of the kind that you described, the visits to the doctor. That is not the area of runaway medical cost increases. It is hospital and acute treatment.

Mr. **Chandler**. I agree. Obviously, we have a difference of opinion on that point.

The other question, if I may—I sensed an inference in your testimony that perhaps there was a great deal of insensitivity on the part of the administration as a motive for bringing out this tax proposal. Did I misunderstand you?

Mr. **Kirkland**. Perish the thought.

Mr. **Chandler**. Then that was not a suggestion in your testimony?

Mr. **Kirkland**. I would make that suggestion, yes, sir.

Mr. **Chandler**. Was that also then the motivation behind the Bradley-Gephardt sponsors of their proposal perhaps?

Mr. **Kirkland**. Perhaps.

Mr. **Chandler**. Thank you, sir.

Chairman **Hawkins**. Thank you.

Mr. Kildee.

Mr. **Kildee**. Thank you, Mr. Chairman.

Both as a Member of Congress and a second-generation member of an AFL–CIO affiliate, I welcome Mr. Kirkland here today. I carry a 30-year-old card in the American Federation of Teachers.

Mr. **Kirkland**. You can't be all bad then. [Laughter.]

Mr. **Kildee**. I appreciate your testimony.

It is interesting that this administration, which is telling us that the private sector should assume a greater role in taking care of social needs is, at the same time, making that more difficult by proposing to lessen the incentives for charitable contributions, and now to tax the fringe benefits. These contradictions seem to be very common in the administration. The same administration that talks against deficits is running up the largest deficits in the history of the Republic.

But you are responding to questions as to motivations. Why do you think the administration is zeroing in on the bulk of the people, for example, in my district whose lifestyle has been improved enormously because they have some protection for their health because of these benefits? What would motivate the administration to zero in on these things that have such an obvious social purpose and help uphold the dignity of individuals? Can you speculate as to that motivation?

Mr. **Kirkland**. Well, I can only surmise, sir, that it was a matter of pure expediency. There is no question that—I believe the figure is $24 billion is what they expect to gain by hitting this vein of taxation. I can only believe, as they say, it was driven by opportunism and expediency without adequate consideration of the consequences, the adverse consequences, with respect to the social and economic effects.

Mr. **Kildee**. It seems interesting that they pride themselves on having cut taxes and, yet, to my mind, it is a question of where they have cut the taxes. The 1981 tax cut, which I voted against with gusto, gave the bulk of the tax cuts to about the top 2.5 percent of the wealthiest taxpayers in the country, including corporate taxpayers. Now they are trying to reach down to the least wealthy and recoup some of the dollars that they gave away in 1981. It seems grossly unfair. Would not that appear to you to be an inequitable way of trying to answer the deficit problems?

Mr. **Kirkland**. I agree with your premises, sir.

Mr. **Kildee**. Thank you very much.

Thank you, Mr. Chairman.

Chairman **Hawkins**. Mr. Armey.

Mr. ARMEY. Mr. Kirkland, unlike my colleague, I have never been a member of a union, but, nevertheless, I welcome you here today as well.

I would like to examine one of the points you made in your testimony—correct me if I am wrong in my understanding—if we impose this tax or bring these benefits into coverage, it is your prediction that many people will choose not to accept these benefits as part of their compensation package?

Mr. KIRKLAND. Yes, sir. I think that includes many employers.

Mr. ARMEY. I would assume they would make that choice only if they had the option to take higher principal pay as a compensation for forsaking these benefits.

Mr. KIRKLAND. No, sir. I think there may be cases where the employer has that judgment to make where there is no union.

Mr. ARMEY. Where there is no union. In that case, would the employer then not have to compete in an open market to get the quality and type workers he must need and offer some form of compensation that would attract to him the workers that he needs to run his business?

Mr. KIRKLAND. You attribute virtue, sir, to the free market in human beings that I don't think reflects the case at a time of heavy unemployment.

Mr. ARMEY. Do you not attribute virtue to the free market into human beings? Is this what you are saying?

Mr. KIRKLAND. I do not attribute virtue to the free market in human beings, no.

Mr. ARMEY. Well, in that case——

Mr. KIRKLAND. The work of a human being, I think it says in the Clayton Act, is not a commodity or an article of commerce.

Mr. ARMEY. I get a little confused then. Why would you want to contribute virtue then to a group of human beings, be they in the Congress of the United States or in the leadership of a union, to give surveillance and guidance and protection to the life of other beings? What human beings do you attribute virtue to and to whom do you do not?

Mr. KIRKLAND. I attribute virtue to the freedom of association in a democratic society, sir.

Mr. ARMEY. Well, if I could follow my line of reasoning, don't you think it is possible that some employees may opt to indeed take a higher money income and buy a personalized benefits package for themselves, one that suits their personal and family needs, as opposed to the needs of a group?

Mr. KIRKLAND. That may well be the case. And I suggest, sir, that as a matter of social policy, that would be detrimental to the development of the most efficient and effective means of providing a system in this country whereby people have some protection against the vicissitudes of life.

Mr. ARMEY. I am afraid I would have to disagree. Wouldn't it be more efficient and effective for me as an employee to buy those benefits that are needed by my family than, for example, at one point not recently when I was in a group plan to pay for maternity benefits that, as part of a group plan, my family would never need or use?

Mr. KIRKLAND. No, sir.

Mr. ARMEY. So that the group's judgment——

Mr. KIRKLAND. Individual policies are the most expensive and the most costly and the most inefficient of providing health care.

Mr. ARMEY. But should the employee himself have the option to decide whether he wants to take a group policy or an individualized policy?

Mr. KIRKLAND. Would you repeat that, sir?

Mr. ARMEY. I don't understand your lack of willingness to allow the employee to have the freedom to decide whether he participates in a group or an individualized policy, which I believe would be one of the possible consequences of bringing this under the tax code.

Mr. KIRKLAND. Group insurance is clearly the most effective way and the least costly way of providing these benefits. Participation in a group in a collective-bargaining environment is determined by the group through a democratic procedure.

Mr. ARMEY. You made a point earlier in response to a question that one of your concerns about this possible action would be that it would weaken the collective bargaining practice. Is that your concern regarding this possible tax policy?

Mr. KIRKLAND. I think I said that it would disrupt the existing harmonious bargaining relationships, that would add a factor that would disturb existing agreements, and that would be detrimental sound labor-management relations.

Mr. ARMEY. So then you do feel that you have a harmonious bargaining relationship with management in the various industries that you——

Mr. KIRKLAND. We have collective agreements, yes.

Mr. ARMEY. So you must have some faith and confidence in those people then with whom you negotiate.

Mr. KIRKLAND. We have faith and confidence that, where they negotiate with us in good faith and where they sign collective agreements, we have a harmonious bargaining relationship and we respect the agreements that we enter into.

Mr. ARMEY. I don't mean to take too much time, Mr. Chairman, but I must say that I am shocked to hear the president of one of the largest union organizations in the world say that he has no faith in the market or the people. I am afraid I am a little flabbergasted.

I want to thank you for helping me there.

Mr. KIRKLAND. I come from South Carolina, sir, and there was a period in my State's history when there was a market in people, and we fought a war to stop that.

Mr. ARMEY. I am sorry, I didn't hear or I don't understand the comment.

Chairman HAWKINS. Would you care to pursue it with another question?

Mr. ARMEY. Well, I just did not hear it.

Chairman HAWKINS. Mr. Kirkland, would you repeat that for the benefit of the group?

Mr. KIRKLAND. I said, sir, that I come from the State of South Carolina. There was a period in the history of South Carolina when there was a free market in people and in the labor and sweat of human beings. And we fought a Civil War to create a more humane society.

Mr. ARMEY. Sir, I came from the United States which, in my estimation still stands clear and proud as the Nation that gives the greatest freedom, dignity, and respect to its people through its corporate processes. I think we are probably going in an avenue here that is not germane to the question at hand.

But I do want to suggest that one possible advantage over this proposal is the individual worker may have a greater freedom over his choice of his benefits package for him and his family which indeed would weaken the collective-bargaining practice.

Thank you.

Mr. KIRKLAND. May I respond to that?

Chairman HAWKINS. Yes, certainly.

Mr. KIRKLAND. The realities of the matter are that the individual worker not represented by a union has a choice to work or not to work for an employer under the conditions that employer decides are going to be present. Only through collective bargaining does he have any power of decision over the terms and conditions of his employment with a particular employer.

Chairman HAWKINS. Thank you.

Mr. ARMEY. Mr. Chairman, I think this is a debate that could go on for many hours, and we don't have the time. I do appreciate your patience.

Chairman HAWKINS. Maybe Mr. Martinez is ready to use his 5 minutes. Thank you.

Mr. Martinez.

Mr. MARTINEZ. Yes, Mr. Chairman, thank you.

I want to enter into a dialog with you because I totally agree with everything you said, but I think there are some people around here who really don't understand it. In the first place, just a little bit on what we just said, the reality of it is that people enjoy group insurance because it is cheaper. Unless you have a lot of money, which might be who the gentleman was referring to, to provide yourself with any kind of a plan you want to, you are really going to look to a group even if you are not a union member.

Now the previous speaker once said he had never been a union member. I am a union member and I have been a union member. I have also been on the other side of the coin. I was an employer. I had my own business for 21 years. I also was a member of the city council and a member of that management bargaining unit. I can tell you this: In most cases, the most important issue ever bargained for was health care. And for years and years, many unions fought for that and bargained for that. They bargained for it and many times were granted that because there were tax incentives there.

Mrs. Roukema mentioned about isn't it fair to those people who have to buy their own plans. I would suggest to her that she and I enter into a piece of legislation that would give a tax credit to those people for the insurance that they buy themselves to eliminate that unfairness.

But there is something very basically wrong with the idea of taxing benefits, especially those health care benefits. I happened to have been part of bargaining units on both sides that the employees argued and the employers gave simply because it was the best way to resolve some of the problems existing at the time and make a more secure and happy employee, and even as an employer make that job more attractive to that employee.

When I was in business myself, I was part of an association which banded together owners of businesses because we didn't have that group insurance—we couldn't provide it for the employees in our shops and, in order to provide it for the employees in our shops, we banded together in this unit so that we could get group rates that would be reduced, so that we could afford to pay for their plans.

So in response to the idea that only union members are considered here, that is not true. There are many employers, in order to attract good employees, who have to provide those benefits, if not for that reason, just for the sake of the fact that it is fair and just and the people should have some kind of a health care policy.

But as I have been studying these plans, the whole basis and the terminology of the administration is revenue neutral—this tax plan is revenue neutral. I have heard that many, many times. So I assume that in the revenue neutral theory that you are going to then with the revenues you collect from taxing the benefits offset some other costs to government. In other words, you are going to take this money here and spend it somewhere else. A part of the argument was that, in order to provide the three tax brackets, 15, 25 and 35 percent, that these revenues would help accomplish that.

Have you or anyone ever studied what it would take to increase those percentages—and I estimate by my figures that it would only be 5 percent, from 15 to 20 percent, from 25 percent to 30 percent, from 35 percent to 40 percent—to leave intact the tax exemption on these tax benefits? Has anyone in the union ever studied how much it would actually take to just leave the tax benefits in place?

Mr. Kirkland. If you don't mind, I would like to pass that to Rudy Oswald, who is my—we have done a wide variety of studies in his department.

Mr. Oswald. Mr. Martinez, the $24 billion that would be collected by the Treasury in 1990 by taxing these fringe benefits could be collected in a number of different ways. Clearly, as you had indicated, the top rate drops from 50 to 35 percent, and for some of those people who have already had a reduction from 72 to 50 percent. So this is one further reduction.

Clearly a more progressive rate structure could collect part of that. There are very large loopholes that have been indicated on the corporate side. There are major problems with capital gains where nearly another $20 billion is lost currently through that single tax loophole where people whose income is not from working, but from investments and other ways, don't pay the same tax as those people who get it from earnings. So there are a number of ways of collecting that money other than taxing fringe benefits.

Mr. Martinez. Thank you.

Chairman Hawkins. Thank you, Mr. Martinez.

Mr. Martinez. Is my time up?

Chairman Hawkins. Yes. You made a very good witness. [Laughter.]

Mr. Martinez. Mr. Chairman, just one word.

I understood what you said, and I agree with you, that the reason why we have so many lawyers and so many contractors is because you can't rely always on the good faith of people.

Thank you.

Chairman HAWKINS. Thank you.

Mr. Henry.

Mr. HENRY. Thank you, Mr. Chairman.

I want to share your convictions that society, insofar as it can, has a moral obligation to ensure availability of health care to its citizens. Obviously we have done it somewhat differently than other countries, with some pluses, and obviously with some minuses as well. I share your concerns in terms—to me, the questions you have raised remain unanswered in terms of the desirability of this overall package.

But I am concerned about this related question of health care cost containment which continues to resurface. It is really not the topic of your remarks, but it is so germane, given the magnitude of the problem both in the private sector, on the side of both labor and management, and mutual concern that both sides have in terms of competitiveness; and obviously in the public sector, with Medicare, Medicaid, and so forth.

One of the things that makes health care different is that we have an oligopoly not of the providers, but of the purchasers. I worked very hard on this problem in Michigan. Increasingly what we found is Blue Cross/Blue Shield with its PPA's—on which I worked hard to get the legislation through—Medicaid, Medicare, DRG's and its bargaining position—you have three or four people bargaining for, as it were, the masses. And then the rest of the people are left outside. Medicaid and Medicare are obviously taking two public blocks, and then the worker who is represented is taken care of.

Increasingly I keep getting reports not just from the providers but from the consumers that cost containment is care containment. I am hearing that from both sides. You talk about a private policy being more expensive. The providers will tell you that is because the cost containment is cost shifting. There is tremendous resentment out there with the small businessman, in the individually insured person, who can't get into a bargained arrangement. As a legislator, I supported over and over again extending drug benefits, mental health, and so forth, through the Blue Cross/Blue Shield system in Michigan and, yet, what happened is that somehow with the magnitude of the contracts, you were bidding down under what was at least established rates.

I am under that system. I recently got reimbursement for a minor thing. Fortunately our family never had a major catastrophic event. My youngest child was just in for minor dental surgery. Blue Cross/Blue Shield theoretically was responsibile for full cost for all—what is the term here—usual and customary charges, and ended up paying 35 percent of the bill in west Michigan where usual and customary charges are below the State average and below the national average. There is so much duplicity going on here that I am wondering if one of the things that ought to be looked at in this is somehow breaking up the purchases to get competition and diversity in the packages.

There was a remark as to whether they were a member of a union. I think I had to join a union here to get a health plan when I came. I think it is a nominal honorary membership, right? I think the chairman would know how that arrangement goes here. So I guess I am a quasi-member to get health care benefits, ironically.

Mr. KIRKLAND. We are not having a per-capita tax. [Laughter.]

Mr. HENRY. I think I am well aware that the reason the group rate is cheaper than the private rate is the collectivity, because of the buyers' size they get the preferred discount service. It is really shifting costs somewhere else, and it is the little guy who is getting frozen out, together maybe with that middle-class person who runs a small business or a farmer who doesn't have these things. The whole issue I am getting at is the reimbursement system and how it is driving up health care costs.

One of the things that intrigues me about Bradley-Gephardt and the administration proposal as a possible—I certainly have not come to a closure on it, it is too complex and too early in this game to come to a closure on that—worthy of positive pursuit is to the extent that it would break up the present system —this breakup can create a proliferation of options and competition in the marketplace, both provider and consumer, that ultimately—in a sense, somewhat different than my colleague was proposing—allows the marketplace to create some benefits even to the workers that are not presently existing.

I am really giving a speech rather than asking a question. But I guess what I am really trying to do is phrase it to see—is there any responsiveness on your part on this, or am I just wholly in the wrong boat, as far as you are concerned, the way I phrased the dilemma?

Mr. KIRKLAND. I don't think, sir, that the—I had not heard that opposition advanced quite that same way, that the structure of the groups' purchasing services could achieve a better result by more fractionalization. I would instinctively sort of feel that that would not be a bet for progress.

The problem of the cost of individual policies and small unit policies is not a factor of the kind, I don't think, you mentioned. Rather, it is the cost of administration and promotion and advertising to sell these individual policies, plus the fact of adverse selection. If people buy policies on an individual basis, you are going to get to the high use of selecting them. That is the essential problem, and that is the essential merit of broad group insurance where these risks are spread out more fully and it makes it possible to apply actuarial principles that are not possible under an individual approach. So I instinctively tend to think that anything that fractionalized the system further would have a bad effect in terms of cost, and in terms of utilization of those who elected to get them, because the higher users would then make that choice.

The problem of cost containment is a very complicated one. There is no question about it. The object, in our view, must be to approach cost containment from the standpoint of preserving access to services and preserving the scope of services, but making it more efficient and somehow dampening the runaway cost areas. There are a number of approaches to it. In the private sector, as I have mentioned, we have worked with management and negotiated arrangements with the providers that would preserve services. Another, I think, of the most constructive approaches has been the development and the encouragement of the use of so-called HMO's, which, I think, have been successful in reducing the length of hospital stays and hospital use. There are a variety of other tools, second opinions and that sort of thing, that come into it.

It is a complicated question, but I think it is essential that it be addressed. We have strongly supported measures that would have some promise of improving our situation in that regard.

Chairman HAWKINS. Thank you, Mr. Henry.

Mr. Owens.

Mr. OWENS. Yes, Mr. Chairman.

I am amazed at the persistence of some of these convoluted arguments. I might first comment that I come from New York, which is a union town and we have some very large unions, but the union members are not employed in big industries where they make a lot of money. They make very little salaries. One of the largest unions, the Hospital Workers, was on strike recently, and most of the workers were making between $10,000 and $12,000 a year, even if they worked all year long. There are some other unions representing school lunch program employees where they make a good hourly wage, but the number of hours is so small that, even if they work the full year, they don't make that much money.

They have very good fringe benefits plans, very good health plans, because of the tremendous numbers. The numbers allow it. It is obvious that if they had to or were seduced into dropping out of plans because of the withdrawal of taxes and status and had to go out as individuals, you would have a situation created similar to the situation now with the deregulation of the banks where banks don't want to even bother with customers who can't maintain a certain balance in the bank. Health care hucksters, plan entrepreneurs, would do the same thing. They wouldn't want to be bothered with people who are at a certain level and can't provide a margin of profit for participation in that plan. It would be beneficial to that free market provider.

So I think it is ridiculous to go on and on making the assertion that people would have choice. Those who need it most would have the least amount of choice. They would suffer a great deal.

And I think that some of these arguments are self-evident, and I think that the administration probably knows also that health care costs, as provided by the public, a number of people will be thrown back onto Medicaid and in various ways be forced to seek their health care through some provider who is really being financed totally through public funds. It would be great. I think they probably know that, too.

I just want to ask one question that I think gets to the heart of the matter, in my opinion. You have been very conciliatory in your comments about the new appointment of Mr. Brock as the Secretary of Labor and, in general, very conciliatory. Do you not see this as part of the singling out of fringe benefits and the going after fringe benefits as much as continuation of the union harrassment and the union-busting tactics of this administration as it is concerned about revenue?

Unions administer a large part of these fringe benefit plans, and I have noticed that it is an important part of what they do. They do a very good job in a place like New York City. The solidarity of the workers is very much enhanced by the fact that they depend on their unions to come through with those various benefit programs, and they do a good job. That is part of their loyalty, et cetera. For unions to lose that, it seems to me, they are put in a position of weakness, and it fits into the general plan of a pattern of activities of this administration, with the people with kinds of attitudes they put on the National Labor Relations Board and the weaking of OSHA and right down the line. The union-busting psychology and the tendencies of this administration now, I think, have taken a new turn, and this is a way to further that aim. Would you comment on that for a moment?

Mr. **Kirkland**. Well, the adverse consequences of this kind of proposal are not confined to union members.

Mr. **Owens**. I am aware of that.

Mr. **Kirkland**. The adverse consequences go across the interests and the concerns and the welfare of working people generally, quite generally. Motivations are locked and veiled in mystery, I suppose, but I think it is all part of a broader problem affecting the whole question of one's view of the appropriate role of a government in a democratic society.

You have to look at this in terms of an administration's approach to the role at government at large. It traces back to the tax cut of 1981, as I noted in my testimony, which stripped the Government of the revenues, on the theory that great things are going to be achieved by detaxing corporate enterprise and those who are most affluent in our society, stripping the Treasury of the resources that are needed to meet human needs, and to promote the general welfare. They have taken a hard line against other alternative ways of raising revenue, and that, together with a massive deficit of the proportions that we are saddled with today, have created a kind of an automatic engine for dismantling the nine functions of the Federal Government as far as the generality of the population is concerned. And this is a piece of that broader pattern with which I say we are in fundamental philosophical disagreement.

As I say, I think the net effect of imposing taxes on group insurance plans of this kind goes above and far beyond any attitude of hostility than its manifest and this administration as it regards trade unions per se. It affects working people generally and adversely.

Mr. **Owens**. Thank you.

Chairman **Hawkins**. Thank you.

Mr. Hayes.

Mr. **Hayes**. Thank you, Mr. Chairman.

I am sorry I missed hearing my fellow trade unionist appearing here before our committee. I have had a chance to glance at your prepared statement, Mr. Kirkland. You can rest assured that I will generally look at it through and through.

I can understand your position, which I share, against the efforts to tax employee benefits, some of which came about during the period of World War II, if you will remember, when wages were frozen and increases weren't allowed. Hence, we started negotiating for fringe benefits.

I can remember one irate employer with whom I was dealing discussing sick leave payments for people, and we happened to hit upon a rather diverse note of having to pay for pregnancy. This employer told me that was nothing but gross negligence and they weren't going to pay for it. This is some of the history of how these kinds of things came about.

I know that your concern goes beyond just the interests of the membership of the AFL-CIO. You are concerned about the interests of the American worker as a whole. I read in the paper where you were going to make a 50-city tour, which came out, I guess, as a result of your recent meeting in the executive council in Florida. As you make this tour, I would like to make one request, that you really—and I know you are better qualified to begin to show the true picture of the impact of unemployment on people, particularly in our urban centers. The true picture is not being told. This administration is painting a picture that things are getting rosy. But it seems pretty clear that even in a period when 7 or 8 percent is the actual figure—and it is somewhat distorted—they seem to be very comfortable with that amount of people out of work.

I hope that you will take a look at the bill which I have proposed, along with several cosponsors, including our illustrious chairman here, Congressman Hawkins, and Congressman Conyers out of Michigan, dealing with the question of income or Jobs Act, House bill No. 1398, because I think the Government has to become an employer of major consequences if we are really going to find solutions to the unemployment problem—but there is work that needs to be done to rehabilitate and redevelop our urban centers particularly. This is the kind of thing that I think we need to think about and put our tax dollars in. And yes, we could reduce our deficit by putting workers back to work so they could begin to pay income taxes. That is part of what this bill is designed to do. It is suggested that we take some of what we spend in military and put into a fund that can provide people with jobs.

I hope you will put some pressures on some of my colleagues to make sure we come forth with the supplementary extension of the unemployment compensation, too, by March 31. There were a number of people on the Hill yesterday pressing for this kind of thing to be done, and I think that maybe the AFL-CIO with some of your colleagues could contact them. Some of them may need a little nudging. I know this is the kind of thing that I think needs to be done. I appreciate any help you can give us, and your staff, particularly in promoting H.R. 1398.

I want to thank you for having come here and spoken out, as you must have done, for the plight of people who need a voice in government.

Mr. KIRKLAND. Thank you, Brother Hayes. I just want to subscribe to everything that you said. To me, one of the worst aspects of the current environment is the kind of complacency that seems to have developed over the problem of unemployment, and the notion that we have a prosperity and full recovery. We have got about officially 7.5 percent of the people in this country unemployed and, unofficially, many millions more unemployed or underemployed and undergoing acute hardship and demoralization.

It wasn't that long ago that the chairman, together with Senator Humphrey, sponsored and got through the Congress the Humphrey-Hawkins Act that defined full employment, as I recall, at 4 percent. We thought at the time that that was a little high, but it was a compromise figure—it was a compromise figure—and it was generally accepted. It was declared in that statute it would be the obligation of the administration to come forward with plans to achieve that goal. You hear a lot about law enforcement in this administration, but that means evidently some laws, not all, and this one has apparently put on the scrap heap, and nobody seems to care very much. We care a great deal. We have these levels of unemployment at peak of a recovery and the economy is beginning to show signs of slowing down. I don't think we have repealed the business cycle. I shudder to think what happens on the next downturn.

Somehow the country has to be reawakened to the fact that this is—sure, we have a lot of problems, we have deficit, we have a trade imbalance, we are losing our industries, and the infrastructure of the country is falling apart. The most wasteful form of public expenditure is not maintaining the essential vital infrastructure of the society. And they don't seem to care. They seem to regard it as good, everything is fine, we have got a boom. But millions of people are suffering. One of the worst, most serious, problems is people in high places and people who comment about people in high places and policies in high places don't seem to give a damn. I think it is high time that more attention and more publicity and more expressions of outrage are directed to this problem of chronic human unemployment and lack of opportunity.

We will, I assure you, through whatever channels and means that we have at our disposal, going to do our best to see that that problem receives the attention it deserves.

Mr. HAYES. Thank you.

Chairman HAWKINS. Thank you.

Mr. Dymally.

Will you reveal your membership in one of the unions, Mr. Dymally? [Laughter.]

Mr. KIRKLAND. I have an application. [Laughter.]

Mr. DYMALLY. Thank you, Mr. Chairman.

Just a brief word to commend Mr. Kirkland for coming up here and presenting such eloquent and profound testimony on the question of employee benefits.

Thank you.

Chairman HAWKINS. Mr. Eckart.

Mr. ECKART. I just wondered if our friend from California would yield his time to me.

Mr. Oswald, let me focus on a point that Mr. Martinez made where I think you could be extremely helpful to us. The trade they want us to accept is zero percent of taxation on fringes on 40 percent taxation on wages for taxing it all at 20 or 25 percent, whatever the number is. I wonder what the net really looks like, what it really works out to be, for a worker in America today who has very little disposable income and may be trying to put somebody through college. I am willing to bet that is not a very good trade.

Mr. OSWALD. Mr. Eckart, for many lower paid workers, many of those who Mr. Owens talked about, the fringe benefits become a very large portion of their total income, so that they will receive a very large tax increase as a result of taxing of these fringe benefits that will not be offset in any way by reductions of rates. The big reduction in rates affects the very highest income people because they receive each of the step decreases as well as the decrease from 50 to 35 percent.

Mr. ECKART. So it is just another part of the bait and switch that we have gotten used to in the past.

Mr. OSWALD. And the other item, Mr. Eckart, is the—let us take something like health care costs. If the package costs $300, it costs $300 for the poor worker who is earning $5 an hour, as well as $300 for that person in the same plant who may be earning $100,000 total. So the tax impact is very small for the very high income person but very large for the low-income person. Health care costs don't vary by income. They are the same regardless of income and, therefore, will disproportionately raise the income of the lower person if they are taxed.

Mr. ECKART. Do you have a study and a convenient chart that perhaps we could circulate to some of our colleagues? I think that would be extremely helpful to us as this debate gets warmer and warmer with each passing day.

Mr. Kirkland, let me ask you directly, having fussed around with this in my younger days as a young lawyer, I wonder if there aren't some serious contractual questions raised. Having followed both sides of labor-management negotiations, it seems to me that many workers forgave salary for fringe benefits, and that they relied upon those contractual negotiations as being part of the base. And we are now changing the rules.

Do you see a substantive or substantial—I guess either word would work—contractual question being raised here as well?

Mr. KIRKLAND. I certainly do, and I indicated that in response to some other questions. I think it will inject a disruptive element into bargaining arrangements that have been concluded. That would be one of the very adverse consequences of this legislation.

Mr. ECKART. In two places in your testimony that I found on pages 3 and 11, you used the words, "no social purpose." Clearly what the Congress has done and administrations have done over the years, as you reference right in your introduction, and I think most appropriately, is when we had social issues we decided to scratch them with tax policy because we didn't have the courage to come out and enact social programs and directly fund them. So what we end up with is a tax policy that isn't really always tax policy, it is social programs.

Given the climate during this administration that certainly has not treated social programs necessarily very kindly, the net result is really a double whammy, isn't it?

Mr. KIRKLAND. That is absolutely correct. As I am sure you very well know, we have been for generations strong advocates of a national health insurance system. This is a double-edged sword. This is one of the barriers. There has been the proposition that, well, the private sector is taking care of this need very well, the spread of these plans, and encouraged by national policy as reflected in that tax cut. And now they propose to strip that with nothing in its place.

Mr. ECKART. That is precisely the point I want to make.

Mr. KIRKLAND. If they would make me the offer, we will take away the taxes, we will take back the tax exemption, we will take that $24 billion back, but we will sit down with you and we will work out a national health insurance system, I would be very interested.

Mr. ECKART. Well, you know they won't take that approach.

Mr. KIRKLAND. Somehow, something tells me that is not going to happen.

Mr. ECKART. That is absolutely correct, and that is precisely the point I wanted to make. We hear, let the private sector do it, and now over 30-some years there has been a clear evolution of private sector provision of a wide variety of socially valuable programs, and so now they want, I guess, the worst of both worlds.

Mr. KIRKLAND. Very well put.

Mr. ECKART. They want to say we don't want the private side to do it, despite their pious rhetoric at press conferences and, "Oh, by the way, we're not going to look at picking up the other end of the stretcher." In fact, there will be a social safety net that will be more hole than net before they get through with it.

The last question I wanted to ask is one of some personal concern to me, and that is, these programs you negotiate for, whatever they are—dental, glasses, prescriptions—are targeted for specific audiences. What is the leverage, however, that an organized contract results in for people who are not organized, who are not the direct beneficiaries of that?

Mr. KIRKLAND. I think it is very considerable. When we negotiate these provisions, there is a multiplier effect, I think, in several directions. Within an establishment where we represent a discreet bargaining unit but not other units of employment in that establishment, what we negotiate becomes the norm for the entire establishment, nonunion facilities as well as union. The tendency of employers to arrange so that the absence of these provisions is not an invitation to one of our organizers to show up leads them then to follow the pattern established through collective bargaining. So, in effect, when we bargain the collective agreement, we are bargaining for a multiple of the people who are actually members of the union. We are effectively representing in collective bargaining many millions more who are not trade members and who do not bear part of the burden of maintaining the trade union.

Mr. ECKART. I would point out to the witness that I also have had a great deal of interest from local chambers of commerce on this issue. Heavens to Betsy, if the AFL-CIO and the chamber of commerce can agree on something, hopefully, the Congress will at least pay heed to one of those two.

Mr. KIRKLAND. That is a rare and remarkable circumstance.

Mr. ECKART. It is always remarkable to me that, when there is a confluence of mutual interests, it is amazing how philosophy and public policy start to reflect and shine in a remarkable way that seems to escape us in most every other set of circumstances.

I thank the witnesses and I thank the Chair.

Chairman **Hawkins**. Are there further questions.

If not, again, Mr. Kirkland, may the Chair thank you for your appearance before the committee, together with Mr. Rudy Oswald and Mr. Ray Denison. You have been most generous in your time, and certainly articulate in your answers, and extremely encouraging to those of us here in the Congress who still struggle against the tide of reaction. It is a great pleasure for us to have someone such as yourself and the AFL-CIO on our side.

Mr. **Kirkland**. Thank you very much, Mr. Chairman, for your consideration.

Chairman **Hawkins**. Thank you.

That concludes the hearing.

[Whereupon, at 12 noon, the committee was adjourned.]

OVERSIGHT HEARINGS ON EMPLOYEE BENEFIT PLANS

TUESDAY, APRIL 2, 1985

House of Representatives,
Committee on Education and Labor,
Subcommittee on Labor-Management Relations,
Washington, DC.

The subcommittee met, pursuant to call, at 10:10 a.m., in room 2261, Rayburn House Office Building, Hon. William Clay (chairman of the subcommittee) presiding.

Members present: Representatives Clay, Kildee, Hayes, Gaydos, Roukema, Chandler, Bartlett, and Fawell.

Mr. Clay. The subcommittee will come to order.

This morning, we continue our oversight hearings begun on March 21 on employee benefits. Today and tomorrow we will focus on national retirement policy. Among the questions we hope to answer through these hearings are the following:

One. Do we have a national retirement policy? If so, what is it? If not, why not?

Two. Is an articulated national policy necessary?

Three. What can workers expect in retirement today, and in the future, as a result of the current policies?

Four. What should our national retirement income goals be and how can we achieve them?

Five. What impediments exist, either in current law or practice, which make it difficult to achieve our goals?

Because we have a very crowded witness list today and tomorrow, I will be brief. These hearings mark the official beginning of a process which has been going on for many months. Members of the subcommittee have become increasingly concerned that the lack of an articulated national retirement policy may have resulted in conflicting and counterproductive legislative and regulatory initiatives.

This concern has grown dramatically as a result of the recent emphasis on deficit reduction. Good tax policy is not necessarily good retirement policy. It is time for all of us to step back and reevaluate where we are and where we are heading in terms of our ultimate goal: making sure hard-working Americans are able to retire in dignity, free of economic anxiety.

These hearings are a first step in a critical process. The subcommittee has several further tasks. We intend to introduce bipartisan legislation addressing some of the problems the hearings identify. The legislation will neither address nor solve all of the problems under the current law. These are complex issues which require substantial discussion and debate, and most importantly, carefully crafted treatment. We intend the bill to be a catalyst for that debate.

Later in the year, the subcommittee will be scheduling additional hearings both in Washington and in the field focused on specific aspects of the bill. The subcommittee also intends to issue a report on the current status of employee benefit plans. The information gathering process began several months ago, and we hope to issue a preliminary report within the next several weeks. I encourage you all to become a part of the process.

Finally, I have one procedural announcement. The subcommittee was flooded with requests to testify at these hearings. Unfortunately, we could only accommodate a small number of requests. The hearing record will remain open until April 24, and I urge you to submit written statements for the record. I regret that we could not accommodate you all, but the extraordinary number of requests we received reinforces the critical importance of the subject before us today.

I want to welcome all of our witnesses and encourage you to be as concise as possible, keeping oral remarks to 5 minutes.

Good morning, Mrs. Roukema. Do you have an opening statement?

STATEMENT OF HON. MARGE ROUKEMA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mrs. ROUKEMA. How do you do, Mr. Chairman. I do thank you. I appreciate your opening remarks, and I shall try to be as brief as possible, without going into the history that we all know of ERISA, and what has led us to this point.

In my opinion it is essential that this committee, which holds joint jurisdiction over ERISA, provide the primary focus for this task of defining retirement income policy. All too often in the past, retirement income policy has been determined from a short-term point of view, with revenue raising concerns as a primary, driving force.

This subcommittee is uniquely qualified, in my opinion, to provide a broader perspective. We can focus on all aspects of the problem. The needs of the employees, the needs of the employers, the impact upon labor-management relations, and the social policy implications.

Let it not be ignored in the meantime that the current huge deficits also weigh heavily upon our minds. So we are fully cognizant of the revenue-raising implications as well. This broad perspective naturally raises many issues. A primary issue was addressed when AFL-CIO President Lane Kirkland last week, during his testimony before the full Education and Labor Committee, stressed the needs being served by the current system of employer-provided welfare and employee benefit plans.

When I asked him about those who are not currently served by this system, he gave me the obvious answer: They should be. While he was referring to the full range of employee benefits, this is a particularly serious problem in the retirement income area, because of employee mobility, breaks in service, and the failure of many employers to provide pension plans.

Those who do not have adequate private pension coverage are left solely with individual savings, which in most income brackets are probably miniscule, or possibly only left with Social Security. I believe that Social Security continues to provide a vital component of our economic support structure, but we simply cannot ignore its limitations. With the 1983 amendments, prompted by legitimate concerns as to the viability of the trust fund, we now have the retirement age increasing, taxation of some of the benefits, and somewhat of a decline in initial replacement rates.

With these and other limitations in mind, we must recognize the implication for future living standards for workers who survive on Social Security alone, as do 15 percent of all current retirees. The principal question I intend to raise in these hearings is as follows: Can the private pension system, the second leg of the triad, so to speak, and individual retirement savings, the third leg, be made more efficient as a meaningful supplement to Social Security?

Mr. Chairman, I look forward to working with you on this very important issue.

Mr. CLAY. Thank you. Mr. Chandler?

Mr. CHANDLER. Just very briefly, Mr. Chairman. I have a statement that I would like to submit for the record, if I may.

Mr. CLAY. Without objection, it will be included at this point.

[Opening statement of Congressman Chandler follows:]

OPENING STATEMENT OF HON. ROD CHANDLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Mr. Chairman, This country, if you can believe what you read, is about to embark upon a major reform of its tax structure. Such a reform could have enormous consequences for employee benefits and pensions. Before we proceed with decisions on tax reform questions, we need to think through a national retirement income policy. What do we want to advance with tax laws and other laws affecting pensions and retirement?

I commend both Chairman Clay and our ranking minority member, Mrs. Roukema, for these timely hearings on an extremely important issue.

Government will have a profound effect on the private sector. As we look at a national retirement income policy, we must look at the broader implications of our actions. We must ask ourselves how we want employee benefits and pensions to develop. Retirement plans and employee benefits must respond to changing needs. Are pension plans for retirement only or should other issues be allowed—encouraged? What should happen with vesting, portability, lump sum distributions?

While significant changes have been made over the past several years in our Social Security system and in the tax treatment of various vehicles used provide retirement income, we have not stepped back from these changes to examine how they should be integrated into a comprehensive policy. While we have looked at individual measures strictly from a tax policy point of view, I believe we should look at broader retirement income policy goals.

The decisions the government makes with respect to key issues such as vesting, integration, retirement age and cost-of-living adjustments for federal employees will influence pension plans offered by private employers and by state and local governments.

The views of all those we are about to hear during these hearings will influence our thinking. We must take steps to plan for retirement and not increase the burden on our children. I thank all of those who participate in these hearings and our Chairman and Ranking Member for their foresight in calling them.

Mr. CHANDLER. Mr. Chairman, I would just like to say that I appreciate yours and Mrs. Roukema's attention to this issue. As I have listened to you and to my colleague, it occurred to me that the tax law is probably used for a number of things. One of them is obviously to raise revenue and another seems to be to encourage some redistribution of wealth. Now we are going to make it simple and we are going to make it fair, but this committee is daring to pause for a moment to look at what that simplification and fairness would do to retirement income for people in this country. I hope that we can gain the attention of the taxwriters in this Congress to what we are doing.

My compliments, Mr. Chairman. I look forward to working with you and with Mrs. Roukema on this issue.

Mr. CLAY. Thank you.

Mrs. ROUKEMA. Mr. Chairman, I ask unanimous consent to have my full remarks inserted into the record.

Mr. CLAY. Without objection, so ordered.

[Opening statement of Congresswoman Roukema follows:]

OPENING STATEMENT OF HON. MARGE ROUKEMA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. Chairman, I am pleased to join you today in this our Subcommittee's first hearing of the 99th Congress. It is appropriate that we are beginning with an issue that we both agree should be at the top of or agenda—the need for a well-articulated National Retirement Income Policy.

While this is our Subcommittee's first hearing on this subject, we cannot ignore the long history which precedes our work here today. Beginning with enactment of the Social Security Act in 1935, the Federal Government has committed itself to a strong role in the area of ensuring an adequate income for our citizens in their later years.

The next major step, itself a product of many years of deliberation, was the enactment of the Employee Retirement Income Security Act (ERISA) in 1974. The purpose of ERISA was to establish minimum protections for those who participate in employer-provided pension plans, while keeping those plans within the private sector.

At various points along the way, the Congress has also built into the tax code various incentives for personal savings, including those, such as Individual Retirement Accounts (IRAs), which are specifically designed to provide retirement income.

These three areas incorporate what is labelled the "three-legged stool" (social security, employer pension plans, and individual savings) upon which our hopes rest for ensuring adequate retirement income.

This system, such as it is, has been thoroughly studied by academia, the private sector, and numerous governmental entities. The most recent analysis has been provided by the National Pension Forum, established by the Department of Labor, and chaired by former Senator Jacob Javits, a key author of ERISA. We will be hearing today from Robert Monks, the former ERISA Administrator for the Department, who organized the Forum.

Not surprisingly, the National Pension Forum reached the same conclusion as all of the others. I quote: "With the acknowledgment that national pension policy should not be construed to dictate individual pension decisions, the Forum recommends that Congress consider formulating an express National Retirement Income Policy; and the policy be explicitly considered when making legislative and administrative decisions regarding the three components of retirement income."

That simple statement defines our purpose today. This is a threefold concern. The first point is to determine what our witnesses think our current National Retirement Income Policy is. The second point is to determine what changes, if any, that should be made.

It is essential that this subcommittee, which holds joint jurisdiction over ERISA, provide the primary focus in this task. All too often in the past, retirement income policy has been determined from a short-term point of view, with revenue-raising concerns as a primary driving force. This subcommittee is uniquely qualified to provide a broader perspective. We can focus on all aspects of the problem: the needs of the employees; the needs of the employers; the impact upon labor-management relations; and the social policy implications, including the need to avoid additional pressures upon existing public assistance programs. Let it not be ignored in the meantime that the current huge deficits also weigh heavily upon our minds, so we are fully cognizant of the revenue-raising implications as well.

This broad perspective naturally raises myriad issues. A primary issue was addressed by AFL-CIO President Lane Kirkland last week during his testimony before the full Education and Labor Committee. Mr. Kirkland spoke eloquently of the needs being served by the current system of employer-provided welfare and employee benefit plans. When I asked him about those who are not currently served by this system, he gave me the obvious answer: they should be. While he was referring to the full range of employee benefits, this is a particularly serious problem in the retirement income area, because of employee mobility, breaks in service, and the failure of many employers to provide pension plans.

Those who do not have adequate private pension coverage are left solely with individual savings—which in most income brackets are probably miniscule—and social security. I believe that social security continues to provide a vital component of our economic support structure, but we simply cannot ignore its limitations. With the 1983 amendments, prompted by legitimate concerns as to the viability of the trust fund, we now have the retirement age increasing, taxation of some benefits, and somewhat of a decline in initial replacement rates. With these and other limitations in mind, we must recognize the implications for future living standards for workers who survive on social security alone, as do 15% of all current retirees.

The principal question I intend to raise in these hearings is as follows: Can the private pension system—the second "leg"—and individual retirement savings—the third "leg"—be made more efficient as a meaningful supplement to social security?

With the changing demographic complexion of our population, we now find ERISA at a crossroads. Clearly, now is the time to ask these questions. We cannot put them off until a later time, when we may be confronted with less acceptable alternatives.

I look forward to working with you Mr. Chairman in addressing these questions in the bipartisan fashion that has characterized our Subcommittee's work in the pension area.

Mr. CLAY. Our colleague, Ed Roybal of California, was scheduled to appear but he has a conflict in schedule. He is now at an appropriations hearings. Without objection, we will enter his remarks in the record at this point.

[Prepared statement of Congressman Roybal follows:]

U.S. HOUSE OF REPRESENTATIVES,
SELECT COMMITTEE ON AGING,
Washington, DC, April 3, 1985.

Hon. WILLIAM CLAY,
Chairman, Subcommittee on Labor-Management Relations, U.S. House of Representatives, Rayburn House Office Building, Washington, DC.

DEAR BILL: I regret that a scheduling conflict prevented me from testifying before your Subcommittee on Labor-Management Relations today. However, I would like to submit for the record the following remarks, which I would have expressed personally had I been able to attend.

While my prepared statement considers problems to be addressed by any national retirement policy, I would like to complement those observations with some general objectives which should form the underpinning of such policy. These objectives are not exclusive, but represent fundamental considerations which might serve as guidance. These considerations would include:

I. THE CONTINUED EXPANSION OF EMPLOYER-SPONSORED PENSION AND HEALTH PROGRAMS AS WELL AS INDIVIDUAL SAVINGS FOR RETIREMENT SHOULD BE THE FIRST GOAL OF ANY NATIONAL RETIREMENT POLICY

The appropriate measure of the expansion coverage is the increase in the size of the covered/participating workforce as a percent of the total workforce. National retirement policy should pursue the goal of ensuring adequate pension and health benefits for all retirees. As ever, Congress must remain aware that those who have the greatest need are the least likely to be covered.

II. TAX-DEFERRED RETIREMENT SAVINGS PROGRAMS SHOULD BE USED SOLELY FOR RETIREMENT PURPOSES

Exceptions to this principle should be limited to distributions in the case of death, disability, or bona fide financial hardship (for example, if the taxpayer became eligible for public assistance). If Congress wishes to encourage non-retirement savings, it should do so with separate tax incentives.

III. FEDERAL AGENCIES WHICH ENFORCE ERISA SHOULD GIVE HIGHEST PRIORITY TO THE PROTECTION OF THE PLAN BENEFITS AND INTERESTS OF PARTICIPANTS UNDER EMPLOYEE- AND EMPLOYER-SPONSORED PROGRAMS.

The primary goal of the federal agencies should be the protection of plan participants, beneficiaries and retirees.

IV. THE COMBINED BENEFIT FROM EMPLOYER-SPONSORED RETIREMENT PLANS TOGETHER WITH SOCIAL SECURITY SHOULD REPLACE A HIGHER PERCENTAGE OF PRE-RETIREMENT EARNINGS FOR LOW-INCOME TAXPAYERS THAN HIGH INCOME TAXPAYERS

Social Security benefits were never intended to constitute a worker's sole source of retirement income. Those low-income taxpayers fortunate enough to receive pension benefits still need to replace nearly all of their pre-retirement income to maintain a standard of living comparable to their pre-retirement lifestyle.

Low-wage workers are typically least able to save for retirement. National policy should seek to establish a preretirement income replacement rate for individuals and families that declines as income rises, wih high-income taxpayers expected to supplement their retirement income with after-tax savings. Pensions which provide all retirees with a uniform replacement rate when combined with social security penalize precisely those employees least likely to have savings to supplement their retirement income.

V. TAX INCENTIVES FOR INDIVIDUAL'S RETIREMENT SAVINGS SHOULD BE DIRECTLY LINKED TO PENSION COVERAGE AND VESTING, AS WELL AS INCOME.

Although individual retirement accounts (IRA's) were intended to encourage retirement savings among those least likely to receive pension benefits in retirement (those with low wages, irregular job tenure patters, and low pension coverage rates) recent data reveal IRA's have the opposite effect. They are utilized at the highest rates by high income, long-tenured taxpayers who are already entitled to vested pension benefits. A majority of those in this high-utilization group are likely to have made at least some of their IRA contributions by shifting money from pre-existing taxable savings or investments. Some even leverage their contributions, gaining additional tax advantages.

VI. FEDERAL RETIREMENT POLICY SHOULD BE "AGE NEUTRAL" WITH RESPECT TO AN INDIVIDUAL'S DECISION REGARDING THE APPROPRIATE AGE TO RETIRE

The trend among many workers is toward early retirement, though a significant portion of the workforce is seeking to extend employment beyond what has come to be considered "normal retirement age." Retirees should be given the opportunity to base their retirement decisions solely on their individual needs or desires. Early retirees are entitled to actuarially fair benefit reductions, but workers choosing to extend their employment are also entitled to pension coverage and actuarially fair pension accruals.

Again, I want to commend you for holding these timely hearings, and express my gratitude for being given the opportunity to express my views.

Sincerely,

EDWARD R. ROYBAL, *Chairman.*

PREPARED STATEMENT OF HON. EDWARD R. ROYBAL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Chairman, members of the subcommittee, I am pleased to appear before this subcommittee to encourage your efforts to develop a national retirement income policy.

The need for a coherent national retirement income policy has been apparent for some time. Even in 1980, as the crisis of social security solvency deepend, the ensuing discussions about protecting benefits heard little analysis or discussion concerning the interaction of proposed social security changes with pension plan coverage and benefits. Recent proposals by the Department of Treasury to "cap" certain employee benefits, including health and hospitalization insurance benefits, view such benefits as "politically susceptible" to attack in an effort to defray mounting budget deficits. A failure to fully appreciate the vital importance and need for the appropriate provision and protection of employee pension and welfare benefits will only serve to ultimately jeopardize the income security, health and welfare, of a large segment of the American public. A national retirement income policy which fully recognizes and encourages the provision of these benefits is needed now.

Critics of the private employee benefit system argue that its advantages are not equitably distributed, and indeed many obstacles to equitable availability of benefits still exist. There are enough obstacles that I can not discuss them all here. I will leave that task to other witnesses. But I want to make clear from the outset that simply slashing tax incentives for employee benefits will not improve tax equity: Absent such incentives only the highest paid, or those with the strongest collective bargaining position, will be provided such benefits. What the private employee benefits system needs now is refinement and reform so it will reach enough individuals to put the justification for its favorably tax treatment beyond question. But that will only happen if the labor committees of Congress, and this subcommittee in particular, show the kind of energy and commitment that characterized the efforts of these committees over a decade ago, when the drive to enact the Employee Retirement Income Security Act began. And it will only happen if the employee benefit community unites with you to help make the system better than it is today.

Today nearly half of the private workforce is without pension coverage, yet we have done little to increase the economic incentives for the adoption of pension plans by small employers. Of those who are fortunate enough to be covered by pension plans, many must forfeit pension accruals when they change jobs because the current 10 year minimum vesting standard is unrealistic given their modern mobile lifestyle. The integration of pensions with social security benefits using methods available under current law can effectively deny lower-wage long-service employees any meaningful pension benefit. Those who vest in a pension or maintain IRA's sometime gain access to their benefit or its present value prior to retirement, spending it on current consumption needs rather than saving it for retirement. Also it is clear that older workers should receive pension accruals after age 65 and thus be treated like younger workers. Simple legislation to extend accruals could be enacted this year.

Likewise, adequacy of health benefit coverage for retirees has proved vulnerable in recent years. Reacting to the recent recession and escalating health insurance costs, some employers have sought to terminate or reduce health coverage for retirees. Witnesses at a recent hearing of the Select Committee on Aging testified that such attempted terminations resulted in part from the failure of many employers to advance-fund their health benefit costs. Yet last year Congress enacted legislation limiting the degree to which some employers and employee organizations can fund their health care costs in advance.

Why should employer-provided welfare and pension benefits be of such great concern to us? Presently, our private pension system represents a reservoir of plan assets totalling over $1 trillion dollars covering 30 million American men and women. Coverage under health and hospitalization programs are even more widespread, representing an estimated $200 billion in unfunded benefits to workers. The amounts involved and the millions of workers who are the recipients of these programs deserve no less than the most prudent exercise of congressional, administrative, employee and employer judgments to assure the provision and protection of these vital benefit programs.

Unfortunately, prudent and concerted judgments may not have been exercised by those with administrative responsibility in these areas. Improvements in benefit coverage, vesting, portability or other features which enhance the benefit security and coverage of workers will mean naught if certain pernicious trends which jeopardize benefit security are permitted to continue. I speak to the continuing and escalating trend of terminations of overfunded defined benefit pension plans and the reversion of excess plan assets to employers. Overfunded plan terminations and reversions represent a "clear and present" danger to the retirement income security of millions of American workers. A Labor Department study of overfunded terminations concludes, in certain instances, that for each $100 of anticipated real pension benefits based on service, workers can expect to loss $45 as a result of these overfunded terminations, Recent data reveal that from January 1979 to January of 1985, 579 overfunded plans, each with over $1 million in excess assets reverting to the employer have been or are about to be terminated. These terminations have resulted in aggregate reversions to employers totalling approximately $5.5 billion, with termination applications presently pending before the federal agencies representing an additional $2 billion. Nearly 700,000 workers have had their retirement benefits affected by such terminations and another 236,000 workers will be affected by pending applications. The number of overfunded terminations continues to escalate. For example, in 1984 an estimated 279 overfunded plans were terminated which is comparable to all of the overfunded terminations (284) occurring over the previous 5 years (1979-85).

Some officials in the administration point to what may be an increasing trend by employers of utilizing spinoff and reestablishment terminations. However, the guidelines do not require that successor plans *must* provide past service credit from the previous plan, nor do those guidelines rquire that benefits in the successor must be equal to benefits promised under the earlier plan. My concern for those guidelines however, does not rest merely with the policy effected by the agencies, it also rests as to the statutory authority of the ERISA agencies to promulgate those requirements. I have addressed those concerns in correspondence to both the Department of Treasury and the Pension Benefit Guaranty Corporation. Recently, a lawsuit was filed in the U.S. District in Missouri which challenges the legal authority of the PBGC to maintain those guidelines. Many of the allegations of plaintiff's brief mirror the concerns which I have raised regarding those guidelines. While I do think it appropriate to prognosticate the court's decision in this matter, I believe that what is clear is that the only opportunity to effectively control the continuing loss of retirement income represented by these terminations and the continuing erosion of employee confidence in the retirement security promises made by employers is for the Congress is to enact appropriate legislation.

To this end, I introduced in the previous Congress H.R. 6404, the Plan Termination and Reversion Control Act of 1984, which will shortly be reintroduced. The bill would, among other features, establish. a "business necessity" test for overfunded plan terminations. If the termination does not meet the business necessity test, such as because of bankruptcy or business hardship, then any excess assets would be ratably distributed to workers who are within five years of normal retirement age and retirees under the plan. The bill would also impose certain restrictions on the conversion of defined benefit plans to employee stock ownership plans, ESOP's which have often accompanied attempts by corporate managements to entrench themselves to resist corporate takeover attempts.

Why is a national retirement income policy needed? The development of the termination and reversion trend represents an illustrative case history. The trend of overfunded terminations which grew during 1982, and 1983, then burgeoned by 1984, did not see any policy treatment of this problem by the ERISA agencies until May, 1984 with the administrations's issuance of its "implementation guidelines". The delay in addressing this growing problem occurred despite hearings held in 1982 and 1983 on "pension asset raids" which called attention to the problem. The bureaucracy of these agencies apparently simply wished to believe that the problem would simply evaporate. Moreover, interagency rivalries, differences in philosophy and approach and differing statutory bases seemed to mire the agencies in inaction. Only when faced with mounting public, press and congressional attention were the agencies able to construct a policy, albeit one which has a dubious statutory and administrative basis.

Conflicting policies were manifest with one IRS Assistant Commissioner declaring that a "step transaction" and "actuarial error" doctrine would be used to stop the "gimmicks" of spinoff and reestablishment terminations, techniques which were subsequently sanctioned by the admininstration guidelines. Presently, the Treasury Department has proposed a 10% excise tax on asset reversions while the executive director of the PBGC decries this proposal as being adverse to defined benefit pension plans. This scenerio of confusing and conflicting policies was most recently manifested by the IRS issuance of the "buck" letter which sanctioned the spinoff of excess assets from a defined benefit pension plan to a profit sharing plan of the same employer. Our committee wrote to the IRS raising concerns that this letter appeared to conflict not only with the exclusive benefit provisions of the code but, also seemed to contravene the requirements of the guidelines themselves. The ERISA agencies have indicated their collective 'concern' with this position and the IRS has subsequently withdrawn the buck letter.

Simply, the administration's "implementation guidelines" on overfunded terminations and reversions have proven to be wholly ineffective in controlling the increasing number of overfunded defined benefit terminations. Rather, those "guidelines" have declared an "open season" on the retirement income security of workers.

What this short history of asset reversions seems to demonstrate is that, in the absence of an overall policy which clearly manifests the security of benefits as being the paramount concern of the enforcing agencies, even the most progressive and well intentioned statutes, such as ERISA, can be left barren and wasted. Let us enunciate a clear and unequivocal policy so that the agencies' mandate is clear. Let me go further, I believe that pursuit of a single agency to administer ERISA is needed so that a national policy can be effectively carried out without fragmentation and dissolution.

This subcommittee has served as a bulwark of protection for employee benefits in the past, and your stewardship in this most important area is needed now. Before other congressional initiatives concerning the taxation and capping of employee benefits gains the ascendency, forthright leadership by this subcommittee is needed to assure the American worker that a benefit promise made is a benefit promise kept.

We need a national retirement income policy; one which embraces the retirement health, welfare and income security of workers, takes recognition of the preferred tax treatment accorded these benefits and respects the legitimate interests of employers in establishing and maintaining these important programs. This committee is uniquely qualified to pursue and accomplish that end.

Mr. CLAY. Senator Heinz was scheduled to appear. He is unable to appear because they are having a markup in the Finance Committee. Without objection, his statement will be entered in the record at this point.

[Prepared statement of Senator Heinz follows:]

PREPARED STATEMENT OF HON. JOHN HEINZ, A U.S. SENATOR IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. Chairman, at the heart of the American "work ethic" is the assumption that a day's work well-done in the present will be rewarded by a secure retirement in the future. It is astounding that as central an expectation as this is, this country has adopted no national policy on retirement income. Nowhere in our complex system of tax incentives, employment practices, or investment regulations have we specifically defined a policy which has as its goal an adequate income in retirement for every American.

Instead, the retirement income Americans receive results from a mixture of programs designed to meet a variety of objectives, only some of which relate to providing adequate retirement income. Social Security provides every worker a floor of income protection. The rest of the retirement income needed comes from thousands of voluntary individual and employer-sponsored pensions and savings efforts stimulated by the Federal income tax system.

Our national goal should be to build adequate retirement income on a stable three-legged stool of Social Security, pensions, and savings. So far what we have is lopsided—a stool balancing precariously on Social Security, with two legs, pensions and savings, that do not not yet touch the floor. Today's retirees rely almost exclusively on Social Security. Nearly 60 percent of those who no longer have earnings have income only from Social Security benefits. Only 35 percent receive a pension benefit. Some argue that this situation is improving, and in fact, a recent study of new retirees found that his group is more likely to have pensions than those who retired a decade ago. Nonetheless, nearly 50 percent of the families retiring today have no pension and another 23 percent get less than $400 a month.

Today's workers may fare no better when they retire. The process of acquiring an adequate pension is still largely an accident of where a person works and for how long. Some workers—mostly those who spend a full career with a good firm—will retire with benefits close to their pre-retirement pay. Others will retire with no pension or with bits and pieces of a pension collected from various employers. You may hear experts blame the individual's own choice of work patterns for this turn of events. Bear in mind, though, that most young people don't set out in life solely to earn a good pension. Instead, most workers chase opportunities and attempt to avoid misfortunes, finding themselves at retirement to be either pension winners or pension losers.

Three basic problems that prevent workers from earning adequate benefits still plaque us even after the enactment of ERISA, and more recently, the Retirement Equity Act. First, not enough workers are covered by pensions; second, many of those who are covered may never earn a benefit; and third, some of those who earn benefits will not retain them until retirement.

Coverage is the most serious problem. Forty-seven million Americans, 43 percent of the workforce, are not covered today by a pension plan. Workers who aren't covered by a plan cannot accumulate retirement benefits. Some will argue that many of the non-covered are young or recently hired and will come under a pension plan if they remain with the firm. But 7 million of the non-covered are part-time workers not likely to be covered by any employer, and 16 million (a third of the non-covered) meet the old ERISA participation standard and would be in a plan if their employer had one.

Simply covering more workers, however, is not enough. Many of those who are covered will still not earn the right to a benefit. Nearly two-thirds of the covered workers are in pension plans that will not provide them with a benefit if they leave a day before they have completed 10 years with the firm. The average worker does not stay at the same job this long. This is particularly true of women who, even at later ages, have typically not been on the same job as long as 10 years. Millions of Americans today are changing jobs and thereby losing the opportunity to earn substantial pension benefits.

Even among workers who earn pension benefits, many may not still have them when they retire. Some employers allow employees who leave to draw a lump sum cash payment of their pension benefits. Although employees may be encouraged to save this money for retirement, few actually do. Recent data indicates that 65 percent of workers who had received a lump sum payment from a previous employer spent it, and only 5 percent actually placed it in a retirement savings account.

These irregularities in the pension patchwork create unfair results. Some workers slip through holes, either forfeiting pension tax benefits or accumulating only meager benefits. Others come under overlapping pieces, accumulating more than their share of benefits from several tax-favored pension and saving vehicles.

Those who fare best in the retirement income system are the highly-paid. Employer plans are designed to provide greater benefits to the highly-paid to make up for Social Security's slant in favor of the lower-paid. In fact, three-fifths of the tax benefits for employer-sponsored plans go to the upper one-fifth of earners in the labor force. In some cases, employers are able to eliminate pension benefits for the lowest-paid workers by integrating these benefits with Social Security. Generally, however, employer pension plans tend to distribute tax benefits more equitably than tax-favored individual savings arrangements.

The tax benefits from Individual Retirement Accounts (IRAs), in particular, advantage the highly-paid. IRAs were originally enacted as a way to provide tax-favored retirement savings to those not covered by a pension. Since 1981, however, they have been available to those already participating in a pension. Not only has the utilization of IRAs been greatest among the highest income groups, but the vast majority of IRA accounts are now held by persons who already participate in employer-sponsored pension plans.

Greater fairness is needed not only in our retirement income programs, but in our tax system as a whole. The tax reform effort we will undertake shortly will dictate the Federal role in encouraging pensions and savings for retirement for some time to come. This work should not be based solely on tax reform objectives. A national retirement income policy is badly needed to guide improvements in income adequacy that can meet tax reform objectives of fairness and simplicity.

We don't have a national policy now to serve as our guide. But I would like to suggest some basic principles we should strive for in creating a fairer and more adequate retirement system.

A tax-favored plan set up for retirement purposes should pay workers their benefits only in retirement.

Plans that enable workers to accumulate capital for other purposes should be treated separately from those designed to provide retirement income.

Firms sponsoring a retirement plan should include all of their regular employees in the plan.

Workers who change employers and have periods of short-service with any single employer should have an opportunity to build adequate retirement income through more rapid vesting and portability of retirement benefits.

Low-paid workers who may eventually depend largely on Social Security benefits should still receive earned pension benefits in retirement.

Tax benefits used to encourage retirement saving should be limited to those needed to accumulate an adequate income for retirement.

As Members of the Congress, we face a delicate task in encouraging any particular results from the voluntary retirement income system. While we do not want to kill the goose, we would feel more kindly toward it if we could get it to lay a golden egg. Those of us who support the voluntary approach and aim to preserve the tax incentives that sustain it must be able to demonstrate that this strategy is the most effective means for providing adequate supplementation to Social Security. Above all, we must be able to demonstrate that the distribution of benefits that results from this approach is fair.

Mr. CLAY. Our first witnesses today consist of a panel. Stanford G. Ross; Robert A.G. Monks; Donald S. Grubbs, Jr.; and Lisle C. Carter, Jr. That is it. Are the witnesses present?

Without objection, all of your statements will be entered in the record in their entirety at this point. We ask you to give a brief summary of what your statements are.

Please proceed.

STATEMENTS OF STANFORD G. ROSS, PARTNER, ARNOLD & PORTER, FORMER COMMISSIONER, SOCIAL SECURITY ADMINISTRATION; ROBERT A.G. MONKS, FORMER ADMINISTRATOR, OFFICE OF PENSION AND WELFARE BENEFIT PROGRAMS, U.S. DEPARTMENT OF LABOR; DONALD S. GRUBBS, JR., GEORGE B. BUCK CONSULTING ACTUARIES, INC.; AND LISLE C. CARTER, JR., PARTNER, VERNER, LIIPFERT, BERNHARD, McPHERSON & HAND, CHARTERED, FORMER MEMBER, PRESIDENT'S COMMISSION ON PENSION POLICY

Mr. ROSS. I guess since I am first on the list, Mr. Chairman, I will start. I am Stanford G. Ross. I am a former Commissioner of Social Security, but I have had broad experience with both the public and private sector programs relating to income security.

Since you were so gracious as to enter my full statement in the record, I will just very briefly make the major points that I would like to call to your attention.

I think you are dealing with one of the most important issues of public policy before the Nation today. I want to commend you for asking the questions you are asking and drawing public attention to the need to develop answers to these questions.

I would also warn you that having just begun the process of clearly defining the issues, I think we are all a long way from having definitive answers. First of all, with respect to your first question of what are reasonable retirement income goals, and what means can be developed to achieve them, I am afraid that the frank answer is that we do not really know today what are reasonable retirement income goals.

Indeed, one of the reasons for developing a national retirement income policy is that in the process of doing this, you will define those goals in a way which attracts broad public consensus. The general public, I think, believes that everyone should be able to retire with roughly the same level of income that they have reached in the years before retirement, which in many cases means the highest level of income that has been achieved during a working lifetime.

The political system has generally attempted to act as if this very optimistic expectation is a realistic goal. Whether these optimistic political actions represent statesmanship or appeasement is a question that remains to be seen in the years ahead. Personally, I believe we have enlarged the Social Security system to the maximum extent that we should pending development of a national income security policy that places it securely within a broader framework.

The private pension system provides a significant supplement to the Social Security system, and one of the chief issues is how much it can be expanded in the years ahead to achieve realistic goals. The concept of mandatory private pensions to force the expansion is troublesome because at that point I think it will be difficult to distinguish the private system from the Social Security system, and the virtues of both systems may well be lost.

I think a very important underlying concept which we all should begin to have is that our public systems and private systems can work together in a mutually-reinforcing and harmonious relationship. I think that we should not fight the battle that has been fought in the past that somehow we see public and private systems as in conflict and antagonistic, and that if we are for Social Security, we are against private pensions. If we are for private pensions, we are against Social Security.

They each have different roles; Social Security is the basic floor; private pensions are a needed supplement, and we ought to find ways to make each act as fully and appropriately as we can. I think you need to take a very broad view. You need to include considerations of health insurance; life insurance; the Medicare Program; tax regulation. I think this is a very broad subject.

By my own count, fully half of the Federal budget deals with income security programs. It is the single biggest domestic issue, and we have failed to even recognize it as such and draw attention to it on the part of the public. I think one first step that is necessary would be to somehow for the executive and legislative branches to get their act together to deal with these issues.

Therefore, one of my specific proposals would be to see in both the House and Senate a joint committee formed on the lines of the Budget Committee, where representatives of say, this committee, of Ways and Means, of Commerce, could come together and deal directly with these issues and integrate both the public and private aspects.

Similarly, if you had an income security committee in the House and Senate, you might develop a professional staff capability that you shared along the lines of the Congressionial Budget Office, which served both. Then you would integrate these tax and social concerns and the rest, and make a more coherent viewpoint available to the public.

I think the peacemealing kinds of changes that have gone on in Ways and Means and in this committee and in other committees often are so short-sighted, they do more harm than good. We have to get a comprehensive, ballistic viewpoint of this area. The Congress should take the first step, and then maybe we could get the executive branch to pull its act together, then we can all make progress towards the goal you want of a delineated and carefully-constructed national income security program.

I thank you, and I am happy to answer any questions you have.

[Prepared statement of Stanford Ross follows:]

PREPARED STATEMENT OF STANFORD G. ROSS, FORMER COMMISSIONER OF SOCIAL SECURITY

I am pleased to have the opportunity to contribute to your inquiry on employee benefits and their relationship to a national retirement income policy. You are focusing on one of the most important issues of public policy before the nation today. I commend you for the penetrating questions that you are asking and the public attention that you are creating for the need to deal with these questions. I will attempt to address these questions as concretely as I can at this point in time. But you must recognize that having just begun to delineate clearly the issues, we are all a long way from having definitive answers.

The first question you pose is what are reasonable retirement income goals and what means can be developed to achieve them. Unfortunately, the frank answer is that we do not really know today what are reasonable retirement income goals. One of the primary reasons for developing a national retirement income policy is to better address this question and to develop a broad public consensus for whatever answer emerges from a deliberative public process.

The general public, I believe, feels that everyone should be able to retire with roughly the same level of income that they have reached in the years before retirement, which in many cases means the highest level of income that has been achieved during a working lifetime. The political system has generally attempted to act as if this expectation of relatively high retirement income for everyone is a realistic goal. Whether these optimistic political actions represent statesmanship or appeasement is a question that remains to be seen in the years ahead. We are acting more on faith than analysis with respect to the governmental commitments that have been made to the public.

Personally, I believe that we have enlarged the Social Security system to the maximum extent that we should pending development of a national income security policy that places it securely within a broader income security framework. The private pension system provides a significant supplement to the Social Security system and one of the chief issues is how much it can be expanded in the years ahead in achieving realistic goals. The concept of mandatory private pensions to achieve expansion is troublesome because at the point where the government removes the voluntary element the private pension system will begin to resemble the Social Security system. The issues of relationship of public and private systems are not easy ones.

Only development of a national retirement income policy can help define the appropriate roles of the public systems and the private systems and this is a task we should get on with quickly. My own feeling is that the developments in both systems can be complementary and mutually reinforcing, and both can help to solve a major issue of public policy. Unfortunately, there are too many who see the public systems and private systems as potentially conflicting and who do not see the possibility of harmonious relationships. While the public and private systems may compete at the margin, each has at its core a distinctive function. The Social Security system is the basic floor of protection for everyone; the private systems build on Social Security to allow the achievement of more adequate goals.

I would note in response to this question that the very large proportion of the federal budget that is devoted to income security programs—I place it at close to 50 percent currently—and the continuing deficit problem are an important backdrop to this inquiry and make it more imperative than ever to get on with the development of basic policy in this area. I would also note that because of the subsidization of private income security programs through the federal tax system and the relationship of basic tax reform to the vitality of private systems that again it would be well to get on with the process of establishing a national retirement income policy. I am very much afraid that both deficit reduction efforts and tax reform efforts may be short-sighted if they are not guided by the larger social goals of meeting the income security needs of the nation.

Your second question is what are the essential components of a national retirement income policy and to some extent I have already given you my answer in addressing your first question. I see the subject broadly and comprehensively and think that it needs to take account of the roles of government, employer-sponsored programs, individual savings programs, regulatory aspects, tax aspects, and social and economic policy broadly.

Specifically, with respect to employee benefit programs, it is necessary to address the areas of coverage, portability, vesting, Social Security integration, retirement plans versus capital accumulation plans, defined benefit versus defined contribution plans, the role of IRAs in providing retirement income, form of distribution from plans and appropriate level of retirement income and retirement ages. Many of these subjects can be dealt with at least partially without development of a national retirement income policy. But I would submit to you that they cannot be dealt with fully and adequately addressed without first having a larger concept of what the nation's goals are generally in this area and having a broad consensus on realistic roles for the private as well as the public sector programs.

I am very much afraid that our attempt to address these matters partially and without a sense of larger objectives may in many cases do more harm than good. I for one am not convinced that recent measures making changes with respect to, for example, employer-sponsored pension programs have been adequately conceived from a conceptual standpoint and technically well implemented by the particular legislative changes that were enacted. It is time to stop piecemealing in these areas and to start seeing things holistically.

Your third question is of what importance are welfare benefits such as health and life insurance in providing retirement income security. The answer here is also that they are very important and that it is a mistake to view pensions and retirement income apart from the entire structure of income security programs. One aspect that makes this obvious is the Medicare program and the health insurance trust fund that is part of Social Security. But on the private side also, life and health insurance, as well as pensions, form a package of benefits that are important to both current retirees and to current workers who are prospective retirees. Again, the need for a holistic view seems obvious.

Your final question raises among the most important issues but here also the answers are speculative. How should a national retirement income policy be implemented and administered? It is clearly necessary to have a more unified administrative structure than exists at present. The current fragmentation between a variety of executive branch departments is inefficient and unsound. Responsibility in a variety of different committees in the Congress can only lead to the continued fragmentation of oversight of this relatively inept executive branch organization. However, before any sort of unification of administration and implementation of programs can take place, we must have some sort of unification of policy focus, both in the executive and legislative branches.

I therefore believe that it would be good to develop legislation immediately that provides for a more unified viewpoint in Congress. This is an action that Congress itself could take and which would bring pressure on the executive branch to act more coherently and responsibly. I see as desirable the development in the House and Senate of Committees on Income Security Policy along the lines of the House and Senate Budget Committees. Representatives from various interested committees such as your own, Education and Labor, Ways and Means, Commerce and others, could be appointed to a composite committee like the Budget Committee where a national income security policy could be formulated. Perhaps the Congress could also developed a staff component on a joint basis like the Congressional Budget Office.

This is one model only and there are others that could be considered. It would be possible to have a joint committee of both the House and Senate, like that on internal revenue taxation. However, I think it would be more acceptable in the current era if the House and Senate each had their own committees and at least achieved that level of unification for policymaking and oversight.

For the Executive Branch, I think the key is to develop some cabinet secretary with income security responsibilities. Here, I would reconstitute the Department of Health and Human Services into a Department of Income Security. I would leave the Social Security Administration as part of that Department, but with an independent operating status. I would have that Department take responsibility, at least on the policy side, for all private income security policy. A model here is the Department of Transportation that unified all transportation programs and produced a Secretary that could take a broad view of the transportation needs of the nation.

My feeling is that your committee could do a great service by developing legislation to provide for some sort of mechanism to bring a policy focus that would allow us to reach a national income security policy as soon as possible. I think that you could do nothing more important in the present Congress to advance the inquiry you are undertaking.

I thank you for inviting me to appear here today and will be happy to answer any questions you may have and to be of whatever help I can to this most important endeavor that you are engaged in.

Mr. CLAY. Thank you.

Who is next?

Mr. MONKS. Mr. Chairman, according to the roster, I was second named.

I am Robert A.G. Monks, former Administrator of the Office of Pension and Welfare Benefit Programs of the Department of Labor. Thank you for the opportunity to testify before you.

In the interests of time, I would like to supplement Mr. Ross' approach by taking a very narrow focus on a single issue. Thank you very much for taking my rather lengthy considerations into the record.

Not having a policy constitutes a policy. At the moment, as the ranking member said in her introductory remarks, retirement income is described in rough terms as a policy combining savings, employer-funded deferred payment arrangements, and Social Security. I want to focus your attention on one aspect of our present system. The present system embraces two extremes without trying to reconcile them.

We envisage a retirement income policy roughly encompassing so-called defined benefit plans that first assures the beneficiary of a fixed level of payments in retirement; second, places the risk of investment failure on the employer, whose liability to pay is ultimately secured up to 30 percent of the worth of the company's equity; third, provides through the PBGC a federally-guaranteed payment in the event of the employer's failure; fourth, restricts access to the capital of the plan, except for retirement purposes; and fifth, deliberately limits the extent to which the plan beneficiary exposes his retirement entitlement to the economic risk encountered by the employer.

We also have a system which appears to be increasingly popular, roughly encompassing so-called defined contribution plans, in which all investment risk is on the employee. The capital is accessible in general for nonretirement income purposes, and whose contribution to retirement income varies. These two alternatives could be characterized respectively as paternalistic and subsidized speculation.

Pejoratives aside, however one feels about the alternatives, it would be desirable to have a balance between the two. At present, we have no policy even suggesting any such guidelines. The failure to have a policy creates the risk of incurring vast tax expense without assuring the achievement of a desired objective, which, in this case, is a level of guaranteed retirement income, as Stan said.

Until we agree on how that objective is to be reached, it is impossible to measure relative success, not to mention costs, benefits or alternatives. One fears, for instance, that the popularity of certain defined contribution plans exceeds their contribution to national retirement income objectives. The question should be raised whether plans permitting generous withdrawal or loans are properly a part of a retirement income system. It is clear that defined contribution plan assets are growing at a significantly greater rate than those in defined benefit plans. I refer the committee to a forthcoming book by the principal economist of the Pension Office in the Labor Department, Mr. Ippolito, in which he sets forth the growth rates for the two kinds of plans that I just spoke of in rough terms.

Some 30 percent of the assets in total pension plans today are defined contribution as against about 10 percent in 1950. In the absence of a policy, it is impossible to measure the cost of the current situation. It would appear that the voluntary nature of establishing private pension arrangements is essential to their wide adoption. Whether it follows that once freely established, a plan must be susceptible to volitional termination is another question. In other words, is the additional incentive of free access to these funds for nonretirement income purposes, whether by way of loan, withdrawal, or plan termination, also essential? In my opinion, respectfully, Mr. Chairman, this is one of the critical questions for this subcommittee to consider.

To require that employee benefit plan assets, which have made use of tax incentives to create retirement income, remain so committed, would at least clarify which, and the extent to which, present schemes actually do contribute to national retirement income objectives.

Thank you very much, Mr. Chairman.

[Prepared statement of Robert Monks follows:]

PREPARED STATEMENT OF ROBERT A.G. MONKS, FORMER ADMINISTRATOR, OFFICE OF PENSION AND WELFARE BENEFIT PLANS, DEPARTMENT OF LABOR

In January 1985 the Office of Pension and Welfare Benefit Programs (OPWBP) of the United States Department of Labor (DOL) conducted Hearings in New York City and San Francisco; during the four days of Hearings we heard testimony from over fifty witnesses regarding the impact of the Employee Retirement Income Security Act (ERISA) in two areas: return on investment and corporate governance. The testimony was lucid and insightful. I have prepared a Summary of Conclusions (the Summary) from those Hearings that is attached to my formal statement before this subcommittee.

One recurring theme of the Hearings is directly related to this subcommittee's inquiry. How does the absence of an explicit retirement income policy affect the operation of our present retirement scheme? Many of our witnesses spoke on this point; one in particular summarized his concern in these words:

> "We still have no national consensus of such critical issues as what is the proper relationship among the parts

of the so-called three-legged stool: employer provided pensions, individual savings and Social Security. What is adequate retirement income? What kind of vesting and portability is appropriate for today's mobile and diverse work force? How should tax policy be used to encourage these retirement goals and, finally, who in government is in charge of this area?

Without such a policy there is no context within which to adequately consider the issues of investment performance."[1] (emphasis added) In brief, the Hearings made it clear that in the absence of explicit policy there are no standards against which to evaluate the asset management and investment performance of the entire pension system.

Retirement income is described in rough terms as a policy combining savings, employer-funded deferred payment arrangements, and Social Security. On the one hand, we can calculate the approximate tax costs of all of the employee benefit plans subject to ERISA.[2] On the other hand, we can deduce the number of persons entitled to payments and their estimated level under existing or projected single employer defined benefit plans. We have, however, no way of knowing what will be available at the time of retirement from defined contribution plans, since all the risk of poor investment performance lies with the beneficiary. Nor do we know the extent to which "savings" should contribute to the final retirement income level. Indeed, it may be extremely difficult to develop a rational policy that includes both tax-aided and conventional after-tax savings. As noted in the Summary, many witnesses expressed concern in the OPWBP Hearings that the popularity of tax-aided savings schemes is so great as to threaten the very existence of conventional or non-tax-aided savings.[3] It would be the ultimate in "cost" if access to tax favored savings arrangements persuaded all Americans to abandon consideration of any savings not so favored.

---

[1] Summary pages 26 and 27.

[2] At the present time, OPWBP does not have access to current data on the 800,000 pension plans governed by ERISA. This poses a serious handicap to policy analysts. Until ERISA Annual Reports (Form 5500 Series) can be filed by electronic media with the Federal government, the data available will continue to be late and incomplete.

Our present system embraces two extremes without trying to reconcile them. We envision a retirement income policy (roughly encompassing so-called defined benefit plans) that (1) assures the beneficiary of a fixed level of payments on retirement; (2) places the risk of investment failure on the employer whose liability to pay is ultimately secured up to 30% of the worth of the company's equity; (3) provides through the Pension Benefit Guaranty Corporation (PBGC) a federally guaranteed payment in the event of the employer's failure; (4) restricts access to the "capital" of the plan except for retirement income purposes; and, (5) deliberately limits the extent to which the plan beneficiary exposes his retirement entitlement to the economic risk encountered by the employer. We also have a system, which appears to be increasingly popular (roughly encompassing so-called defined contribution plans), in which all investment risk is on the employee, the capital is accessible for non-retirement income purposes, and whose contribution to retirement income is questionable.

---

[3] Summary page 32, fn #27.

These two alternatives could be characterized, respectively, as "paternalistic" and "subsidized speculation".[4] Perjoratives aside, however one feels about the alternatives, it might be desirable to have a balance between the two; at present, we have no policy even suggesting any such guidelines.

The failure to have a policy creates the risk of incurring vast expense without assuring the achievement of a desired objective, which in this case is guaranteed retirement income. Until we agree on how that objective is to be reached, it is impossible to measure relative success, not to mention costs, benefits, or alternatives. One fears, for instance, that the popularity of certain defined contribution plans exceeds their contribution to national retirement income objectives.[5] The question should be raised whether plans permitting generous withdrawal or loans are properly a part of a retirement income system.

It is clear that defined contribution plan assets are growing at a significantly greater rate than those in defined benefit plans. As the chief economist of OPWBP summarizes in a book to be published in the fall of 1985:

---

[4] The testimony in the OPWBP Hearings contained a great deal of evidence that asset turnover is very high in the case of all employee benefit plans, estimated to be 70% of market value per year by SEI in October of 1984.

[5] The Hearings suggest that the question should be asked, "popular with whom?" It is far too early to determine whether or not a defined contribution system will "work" in terms of investment performance, but it is not too early to note the profitability of these plans to service providers.

> "...The data confirm the widespread belief that defined contribution [DC] plans are becoming a progressively more important form of pension plan. Indeed, in 1981, assets in defined contribution plans represented approximately 28% of all private pension assets...In 1950, the DC-plan asset share [was] 11.6%...The growth of DC-plan assets is expected to increase at a faster rate than DB-plan assets."[6]

There is a need to ensure that defined contribution plans are in fact promoting legitimate retirement income objectives or at least to understand whether the restricted use of such funds for non-retirement income purposes continues to be appropriate.

In the absence of a policy, it is impossible to measure the costs of the current situation; conclusions as to desirable changes are therefore particularly dangerous. It would appear, however, that the voluntary nature of establishing private pension arrangements is essential to their wide adoption. Whether it follows that once freely established, a plan must be susceptible to volitional termination is a further question. In other words, is the additional incentive of free access to these funds for non-retirement income purposes, whether by way of loan, withdrawal or plan termination, also essential? This should be one of the critical questions for this Subcommittee to consider. To require that employee benefit plan assets, which have made use of tax incentives to create retirement income, remain so committed would at least clarify which of the various schemes in use actually do contribute to national retirement income objectives.

---

[6] Ippolito, Richard, Pension Economics, (January 1985), at page 146. To be published by Richard D. Irwin in fall 1985 in the Pension Research Council (Wharton) monograph series.

U.S. Department of Labor

Enclosed for your review is a summary of the hearings conducted in New York and San Francisco by the Office of Pension & Welfare Benefit Programs (OPWBP) in January 1985. This summary was prepared by Robert Monks, the former Administrator and Janet Brown, Special Assistant to the Administrator. A copy of the transcript of the hearings and materials submitted for the record are available for review in OPWBP. The Department welcomes your comments on the summary. Written comments should be directed to the Office of the Administrator, OPWBP, 200 Constitution Avenue, N.W., Room S-4516, Washington, D.C., 20210. The record of the hearings is in the process of final verification by the participants. When this process is complete a final summary report will be compiled with new page references and amended quotes as necessary.

UNITED STATES DEPARTMENT OF LABOR
OFFICE OF PENSION AND WELFARE BENEFIT PROGRAMS
PUBLIC HEARINGS

NEW YORK CITY 1/9 and 1/10/85
and
SAN FRANCISCO 1/14 and 1/15/85

Summary of Conclusions from Hearings

I. Prologue

In January 1985 the Office of Pension and Welfare Benefit Programs (OPWBP) conducted Hearings focused specifically on investment performance and governance issues. The scope and quality of both written and oral presentations provided valuable insight into the nature of the American private pension system under the Employee Retirement Income Security Act (ERISA). The concerns voiced served as compelling reminders that there has been no comprehensive oversight review of ERISA since its passage more than a decade ago.

The Congressional consensus that accounted for ERISA's passage was slender. We are told that Congress knew that it was conferring identical jurisdiction on two federal departments; it also acknowledged that the Act contained no explicit retirement income policy objectives. Simply stated, Congress could not agree to anything else, and flawed passage was considered preferable to no passage. With the departure of Senators Williams and Javits and Congressmen Burton, Dent, and Erlenborn, there is no longer an institutional memory in the national legislature regarding ERISA. This situation is increasingly true among committee staffs as substantive issues have been claimed by finance-oriented committees. In recent years, there has been extreme reluctance to "open up ERISA", largely because no one feels comfortable with the statute, and therefore wouldn't want to vote on amending it.

It is not hard to understand why there have been so few detailed inquiries into the industries fostered by ERISA (hereinafter referred to as the "industry"). The legal and administrative structures of ERISA are intricate to the point of discouraging any but the indomitable. The language is confusing, full of special purpose acronyms (PBGC, SOL, OPWBP), legal shorthand (exclusive benefit rule, prudent man rule), and special numbering (Title I, S406(b), S408); that ERISA fiduciary considerations are to prevail over all other public policy interests is unmistakable, but the implications are not spelled out. The law is all-encompassing; its impact on American society ten years after passage can only be guessed.

Congress' determination that ERISA funds were to be different from other funds, and that a trust relationship was to characterize all dealings with reference to ERISA assets, are plain in the statute. That ERISA was to preempt all state laws that purport to regulate employee benefit plans is likewise clear. Yet we can only begin to articulate a few of the unmistakable consequences of ERISA; savings are considered to be interchangeable with pensions in providing for retirement; tax-aided savings schemes have grown beyond anyone's contemplation, raising the spectre of a new Gresham's law in which savings that are not tax-aided would be driven out of existence.

The original division of ERISA administration between a new federal corporation and two existing departments was a source of confusion that has only mildly abated over the last ten years. Oversight and legislative responsibility for ERISA is spread among a variety of Congressional committees, each focusing on discrete aspects of the industry: these include operating expenses, enforcement, relationship to other retirement income programs, labor relations, and tax cost.

There is no committee responsible for all of ERISA, which is why so many important issues are "lost between the cracks" of conventional oversight.

The industry has gotten so large -- it is estimated that ERISA assets will comprise more than half of all debt and equity in the United States by the turn of the century -- that the mere fact that such a significant proportion of the nation's assets are considered "special" is a growing problem in itself. The classic definition of a trustee's duty is that he is to have "morals, above the morals of the marketplace"-- how will this be possible when the "res" of the trust is so large that it literally constitutes the market place?

As it involves more than one trillion dollars in liquid assets, the industry is one of the largest in America today. OPWBP estimates that this figure will rise to three trillion (in constant dollars) over the next fifteen years. Consider what this means:

- In many cases, the value of a company's pension plans is greater than the market value of that company's assets, even if it is a large entity.

- Expenses for employee benefit plans are the second largest source of business expense (after direct salary); tax deductions for the industry are the largest single federal income tax reduction.

- Institutions are becoming the dominant factor in stock trading markets, and pension plans are the dominant institution.

- The industry is collectively the largest shareholder in corporate America; indeed, its ownership percentage has reached the level that no reference can be made to the ownership or governance of corporations without taking pension plans into account.

- The industry will be the preponderant source of new financing for American industry. Clearly, the amassing of such a sum of assets under a new and largely exclusive law has led to predictable confusion.

ERISA attempts to do many things. It makes employee benefit plans special and applies complex procedural and substantive burdens without differentiating (except in applying some technical rules) between plans that are essentially equivalent to savings (defined contribution) and those with traditional pension characteristics (defined benefit). Mechanisms that permit the tax-free investment of funds are popular and Congress has enthusiastically manufactured new ones and enhanced the attractiveness of old ones, e.g., IRAs and Keoghs, §401(k) and ESOPs. Vast cash flows have been redirected into these new vehicles, all of which are nonetheless subject to ERISA.

Policy contradictions are inherent in these various schemes. The considerations that lie behind making an individuals' pension independent of the economic fate of the sponsoring company are contrary to those behind profit sharing and employee participation plans; the former are intended to protect pension funds from the employer's business downturns, while the latter are intended to encourage employees to share the gains (or losses) of their employer. Even-handed application of the law to both savings and pension plans can only be "benevolently arbitrary" in the absence of a policy suggesting their relative priority.

ERISA mandates that all plans have a fiduciary and that the fiduciary comply with strict standards of conduct. It goes on, however, to permit the delegation of fiduciary responsibility. The status of a fiduciary seems unenviable: incentive compensation for superior performance, if permitted at all, is certainly confined; liability for error is vast. What seems to have happened is that those who are primarily responsible -- the plan sponsors -- have been more concerned with insulating themselves from liability than with involving themselves in the process of obtaining superior results. In the process of demonstrating "prudent" conduct, the majority of ERISA fiduciaries have therefore called in "expert" consultants. The apparent result can hardly be that intended by the ERISA sponsors: a system with little incentive for superior performance and unusually high operating costs, all to insulate against the strict level of liability mandated by statute.

ERISA reflects a voluntary policy: no company in America is legally obligated to create pension plans, and having done so, no company is legally obligated to continue them. Thus, all who are subject to ERISA have chosen to be so. This has created a strange disequilibrium: failing pension plans are guaranteed by the government; plans successful beyond the actuarial commitments create value -- tax-free -- to which plan sponsors have access at any time. Stated boldly, the burden of ultimate failure in investments is the government's, the benefits of success are the plan sponsors'. Perhaps incentives of this kind are necessary to induce so many firms to create pension schemes voluntarily. By all statistical measurements, including the number of plans, the levels of vesting, the number of participants covered, and the volume of aggregate assets, the American pension system has grown over the ten years of ERISA. Whether these statistics translate into the responsible conclusion that the impact of ERISA on retirement policy is cost-effective remains to be proven.

Testimony provided by service providers must be viewed against the backdrop that those providing services to ERISA plans have prospered. One concludes that service providers, while well paid, have been conscientious in their efforts to carry out the statutory policy. The problem in interpreting testimony arises from the understandable tendency of each "expert" to view the ERISA world from his own perspective. No single institution in the private sector is responsible for considering whether the system as a whole makes sense, or whether particular aspects of it could be accomplished more economically.

The picture, then, is one of a statute that is not understood and that contains internal contradictions; unprecedented asset pools; professional service providers responsible for compartmentalized duties; no special rewards for superior performance and perceived strict accountability for deficiencies; no oversight for the system as a whole; no statistical basis for comparing the costs and benefits of the system; no differentiation between the desirability of savings or pensions.

In effect, ERISA created a new world which is considered "legitimate" because it provides retirement income. Since the statute doesn't define "retirement income", all are free to adopt their own definitions, to pursue their own goals, and to declare in all sincerity that they have been successful. Coincident with the passage and growing importance of ERISA, there has been an increase in daily trading on the New York Stock Exchange to 100 million-share volumes per day, annual turnover rates for ERISA funds approaching 70%, and a frenzy of corporate take-overs. Whether there is any correlation between these developments should be considered further.

The OPWBP Hearings do not provide the many answers that together would give a comprehensive picture of the health of retirement income programs in America today. Because of the extraordinary generosity of the participants, who openly and thoughtfully shared their knowledge, it is possible, however, to suggest certain conclusions. It is hoped that these Hearings will stimulate further investigation by branches of government with greater jurisdiction and resources, for the issues reach far beyond DOL's responsibilities. The Hearings provide the opportunity to reflect, speculate, and hazard conclusions as to the impact of ERISA on various aspects of retirement income policy and practice, as well as on the specific subjects of investment performance and governance. They also suggest the necessity of joint evaluation of ERISA by the Executive Branch and Congress.

The summary that follows is cast in two parts: the first is a consideration of investment performance and corporate governance, and the proposal of certain institutional mechanisms for their future study; the second is an effort to analyze the wide range of testimony in an effort to understand what the real impact of ERISA has been.

II. Hearings

The Office of Pension and Welfare Benefit Programs (OPWBP) of the Department of Labor (DOL) is responsible for administering Title I of the Employee Retirement Income Security Act (ERISA) of 1974. In order to improve understanding of its responsibilities in this area, OPWBP held Hearings on the investment and voting of securities that are subject to ERISA.

By Federal Register notice, OPWBP solicited expert testimony on these issues. During the first set of Hearings in New York, twenty-six individuals testified personally and two submitted written statements. In the San Francisco Hearings, there were twenty-three submissions. The Department is very grateful for the scope of the testimony submitted, the range of viewpoints represented, and the care that went into preparing testimony on such a difficult subject.

The witnesses included:

State Treasurers

Henry Parker of Connecticut
Jesse Unruh of California

Money Managers

Dean LeBaron
of Batterymarch Financial
Management Corporation

Peter Vermilye
of Endowment Management
& Research Corporation

Roger Bransford
of Meridian Management
Company

David L. Heald
of First Chicago Investment
Advisors

William D. Witter
of William D. Witter, Inc.

Richard Barker
of Capital Guardian Trust
Company

Theodore M. Theodore
of Morgan Stanley Asset
Management

John Kennedy
of H.J. Meyers & Co.

Lloyd McAdams
of Security Pacific
Investment Managers, Inc.

Herbert M. Hanson
of Hanson Investment
Management Co.

Alan G. Seidner
of Alan G. Seidner
Investment - Financial
Consultants

Douglas Dorn
of Dorn & Hellison

Arthur Williams III
of Merrill Lynch

Jeffrey Diermeier
of First Chicago Investment
Advisors

Kenneth Cutler
of Cutler & Co.

Vernon S. Hodge
of William M. Mercer -
Meidinger, Inc.

John Crichton
of Commonwealth Group

Lambert C. Thom
of Bangert, Dawes, Reade,
Davis, & Thom, Inc.

John Hartz
of Mutual Life Insurance
Company of New York

Ralph L. Knisley
of Irving Trust Co.

Lawyers

Hugh Calkins, Esq.
of Jones, Day, Reavis &
Pogue

Alvin D. Lurie
of Meyers, Tersigni,
Kaufman, Lurie, Feldman
& Gray

Frank Cummings
of Cummings & Kershaw, P.C.

Christopher J. Sues, Esq.
of Shea & Gould

Professors

Dennis Logue
of the Amos Tuck School
of Business, Dartmouth
College

Stephen Ross
of Yale University

Joseph Auerbach
of Harvard University

Marshall Blume
of The Wharton School,
University of Pennsylvania

Roger Murray
of Columbia University

David Ratner
of Cornell University

Myron Scholes
of Stanford University

Roy Schotland
of Georgetown University
Law School

Robert M. Soldofsky
of University of Iowa

Consultants

Dennis Tito
of Wilshire Associates

Hillel Gray
of Investor Responsibility
Research Center

James E. Heard
of Investor Responsibility
Research Center

Stephen Berkowitz
of Berkowitz, Logue &
Associates, Inc.

Thomas Brophy
of Moseley, Hallgarten,
Estabrook & Weedon

Louis O. Kelso
of Kelso & Co.

Sophie Korczyk
of Employee Benefit
Research Institute

Peter O. Dietz
of Frank Russell Co., Inc.

Irving Baldinger
of American Benefit
Plan Administrators

Donald Korn
of Arthur D. Little, Inc.

Jack Treynor
of Treynor-Arbit
Associates

Douglas Borton
of Buck Consultants, Inc.

Plan Sponsor

Graham O. Harrison
of U.S. Steel & Carnegie
Pension Fund

Public Retirement System

Clark Manning
of Teachers' Retirement System
of Texas

Plan Administrator

George W. Lehr
of Central States, Southeast &
Southwest Areas Pension Fund

III. Summary of Conclusions

The conclusions derived from written submissions and the Hearing transcripts can be summarized as follows.

A. The Hearings manifested that there are no policy objectives, no measurement system that is uniform in the industry, and no substantial body of data that reports performance in a consistent manner, and that no conclusions can be drawn as to the absolute value of asset management. Therefore, it is not possible at the present time to conclude that the costs (meaning the revenues foregone by the Treasury Department) of ERISA are justified by its benefits in creating retirement income for Americans.

B. ERISA requires that fiduciaries act prudently with respect to assets under their trust, including the right to vote shares of stock. Current institutional arrangements which customarily delegate voting rights to money managers are not effective for a variety of reasons, including, in some circumstances, serious conflicts of interest. It is clear that plan sponsors need to act with a greater proprietary sense, possibly by retaining voting rights and by developing new institutions to articulate ownership rights in a way that protects plan beneficiaries.

C. Department of Labor (DOL) must improve management of ERISA annual report data (Form 5500 information). Complete, timely statistics are critical to informed decisions regarding the costs and benefits of ERISA.

D. DOL must act as a catalyst in encouraging private industry to develop common standards of measurement for ERISA fund performance.

E. DOL should consider promulgating regulations clarifying the obligations of fiduciaries to exercise voting rights of portfolio holdings. Specifically, DOL should consider issuing a regulation under Section 404(c) to define voting responsibilities under self-directed plans and the extent to which they apply to ESOPs.

F. DOL should assist plan sponsors in developing one or more self-regulatory organizations (SRO) in order to make private sector expertise available in analyzing increasingly sophisticated ERISA proposals.

The most important aspect of the testimony is the insight that the material as a whole provides on the workings of the industry under ERISA. The testimony serves as a framework within which one can consider the range of possible answers to the questions posed in the Federal Register Notice of Hearings. Analysis of the testimony is therefore organized to consider: problems created by the statute's "incentive to delegate" and the according need for renewed involvement by plan sponsors; the lack of explicit goals for retirement income and its impact on investment performance; and shareholding owners' need for a new way to express their interests.

IV. Fiduciary behavior under ERISA: the need for involvement by plan sponsors as proprietors

A. Delegation of responsibility

In defining appropriate fiduciary conduct, ERISA mandates a "process" rather than any particular objective standard. The Act requires that each plan have a trustee, that the trust relationship be formally set forth in writing, and that the trustee accept his responsibilities. In effect, the Act is designed to be insurance against the worst abuses dealt to employee benefit plans prior to 1974.

The focus on process has resulted in several sequential delegations of responsibility. In the first instance, plan sponsors have delegated substantial responsibility for managing both parts of plan assets: the material value and the voting right that pertains to shareholdings. The latter problem is addressed in section VI of this paper. The former affects return on investment, which will be discussed here.

It was widely acknowledged by witnesses that plan sponsors do pass on much of their fiduciary responsibility, and that, indeed, they would be foolish not to. 1/ ERISA

1/ Hearings on Pension Fund Investments and Corporate Governance before the Office of Pension and Welfare Benefit Programs, U.S. Department of Labor (hereinafter referred to as "Hearings"), transcript, 1/9/85, p. 73, Professor Stephen Ross. "Rather than shouldering the responsibility itself, a sponsor would be irresponsible if it didn't call in a consultant on whom it could lay off risk."

Hearings, transcript, 1/9/85, Christopher J. Sues, Esq., p. 251. "Rather than focusing on what is good for the fund, taking an active role in getting a proper rate of return...your focus is 'I am not liable; ...let them do it. I can pay them $35,000 a year to lose my money but they are the
(Footnote Continued)

fixed a level of accountability with respect to employee benefit plans that can be bypassed through the reasonable delegation of responsibility (specifically authorized under ERISA[2], although forbidden of a fiduciary under the common law). As Professor Stephen Ross wrote: "The division of [the legal fiduciary] responsibility between the sponsor and others had already been determined competitively and the law, by raising the sponsor's share, had predictable consequences."[3] In the views of Professor Ross and others[4] these consequences include: the development of a redundant consulting industry ("ERISA is a make-work program for pension fund consultants"[5]), the concentration of the money manager industry (can you be criticized, to say nothing of being

---

(Footnote Continued)
best in the industry...So we will just let them do it.' I see it as an abdication problem."

[2] Hearings, transcript, 1/14/85, Herbert Hanson, p. 231. Answering Deputy Administrator Lebowitz' question as to why the consulting industry has grown so much over the last ten years. "And I think one of the reasons is because...of ERISA, maybe they think we are more conscious of the responsibility now and they're looking for that buffer." (emphasis added)

[3] Hearings, 1/9/85, written statement by Professor Stephen Ross, p. 8.

[4] Hearings, transcript, 1/14/85, Professor Myron Scholes, p. 158. "ERISA has brought about a demand for more insurance against suits. For these reasons, it may have contributed to the growth of the consultant, manager searches, evaluation services and style definers."

[5] Professor Stephen Ross, op. cit., p. 8.

surcharged, by picking one of the "big, old and reliable firms?"[6]), and the stultification of new investment ideas. Moreover, delegation makes it increasingly difficult to assign responsibility for any specific acts (or failures to act).[7] No identifiable party is in control. This situation cannot work to the benefit of plan participants.

B. Investment Consequences

The plan sponsor's initial decision to delegate sets off a sequence of hand-offs. Testimony made it clear that in the investment area, "process" has encouraged two developments. One is strict adherence to practicing "conventional wisdom" in the industry. There has been no perceived need to consider absolute values, like a real return after inflation. It has appeared that responsibilities are fulfilled by following the example and approximating the results of the other industry participants.[8] Results, however, historically have not had a direct relationship to any given money manager's level of business. Indeed, incentive compensation is practically non-existent. Though this would seem to be an appealing way to sort out the managers who are earning real returns, the only reference to incentive compensation in the hearings was wistful.[9]

---

[6] Hearings, transcript, 1/14/85, Alan Seidner, p. 280. "...often we are passed over for larger firms that have substantial assets under management and a very long history and so on and so forth, because these people on the pension committee are always concerned about their liability...(the) time and effort that they have placed with a consultant is, in essence, an insurance premium that they're paying...if something does go sour--...mismanagement or bad decisions...--they can in fact bring up these various layers of protection."

[7] Christopher J. Sues, Esq., op. cit., p. 238. "I think that you really have a situation that has deteriorated to the point that as long as the trustees are walking out of a room knowing that they cannot be held fiduciarially liable or held on fiduciary liability they are satisfied."

Process also results in sheer activity. The herd phenomenon exhibited by money managers has also spilled over into the areas of performance measurement, where teams of consultants join the fray. While the sponsor is presumably concerned only about his plan(s), those whom he has hired as money managers are busy measuring the performance of their overall funds, whose return can be used as a marketing tool. Enter the consultants, who produce elaborate computer charts comparing the relative performance of particular funds. In the absence of uniform performance standards, however, these numbers can prove any desired result (see section V). As a consequence, performance measurement is largely one more "process" that adds only marginal value to the plan.

---

[8] Hearings, transcript, 1/9/85, Jeffrey Diermeier, p. 222. "...there is a tendency on the part of the pension plan investment community to look to each other to determine their investment policies as opposed to their own best judgment..."

Professor Dennis Logue, who is conducting a detailed survey of investment practices for DOL, concludes unequivocally that the fault for an unproductive modus operandi is the plan sponsors'. See Hearings, transcript, 1/9/85, Professor Dennis Logue, p. 26.

[9] Hearings, transcript, 1/14/85, Lloyd McAdams, p. 72. "If I do not exceed the objectives for the three-year to five-year horizon, then I get a negative fee, which I will be more than happy to pay to the client. ...I think you might find a lot of people dropping out of the money management business if they had to perform to get paid."

A final aspect of the delegation problem arises from the fact that in making fiduciary responsibilities unmistakably apparent, ERISA seems to have tilted the risk/reward ratio away from accountable sponsor involvement. From the sponsor's point of view, aggressive involvement in corporate defined benefit plans is a risky proposition at best. If he wins, the corporate sponsor may be able to defer the obligation to fund defined benefit obligations; if he loses, he can be held liable and will, in any event, be required to restore the employee benefit plan to the extent he caused losses. The sponsor sees himself (as does the statute) as a guarantor of fund investments, a perception that hardly creates an incentive to be imaginative or to take chances,[10] and that removes inhibitions against delegation.

The result is that the preponderance of ERISA's funds are now, and probably will continue to be, invested in the securities of the largest, least controversial American issuers. With ERISA funds constituting a majority of American investment capital within a few years,[11] it must be asked whether it is in the nation's interest to have seemingly "sterilized" ERISA funds.[12] Predictably, "uncertainty ... by itself has led to increased conservatism in behavior."[13/] It is not surprising that this leads to indignation and concern from certain ERISA constituencies who have a direct interest in the investment of funds. "(The)...DOL must bear the greatest share of responsibility for perpetuating the myth that ERISA's prudence rules contain some kind of incorporeal standard that makes anything less then the highest 'prevailing' interest rate an imprudent investment."[14/]

---

[10] This is ironic since the present situation allows a risk-taking management to exploit the statute to advantage.
Hearings, transcript, 1/14/85, Dennis Tito, pp. 200, 204. "You have an opportunity here for the sponsor to gamble. If the sponsor goes ahead and takes a lot more risk, hires active managers...there may be a windfall and there may be an opportunity to reduce costs or to terminate the plan...your downside is protected in the sense that the corporation has limited liability. But they can terminate their plan if it is not doing well..." In essence, the government guarantees payment in the event of corporate failure and there is no obligation to continue a plan. This gives an enterprising corporation a rare chance to have its cake and eat it too.

[11] Richard A. Ippolito, Pension Economics, Richard D. Irwin, publisher, to be published fall, 1985. See generally chapters 1 and 2.

[12] The legislative history of ERISA makes perfectly clear that the problem of conservative investment of capital was addressed. There is specific permission for plans to adopt a comprehensive investment strategy including a portion for investments with a risk profile that would otherwise not have been suitable under the common law for fiduciary investment.

In addition to highlighting the problems of delegation, the Hearings also yielded a spontaneous (and universal) expression that it is time for the plan sponsor to take back his power, and thereby break the stalemate that results from a well-paid network of service providers who lack ultimate responsibility.[15/]

[13/] Hearings, transcript, 1/9/85, Professor Stephen Ross, p. 85.

[14/] Hearings, 1/10/85, written statement by Robert Georgine, p. 7.
This perception exists despite DOL's promulgation of a "liberal" definition of prudence under Section 404 and several specific statements by Administrators delineating the permissible scope of "social investing."

[15/] Hearings, transcript, 1/10/85, Professor Roger Murray, p. 7. "Those who have the real authority and responsibility are the plan sponsors."
Hearings, transcript, 1/10/85, Clark Manning, p. 168. "I think that we must return the investment responsibility to the boards and the sponsors, fiduciary responsibility, and not to the outside money manager."

V. Cost/Benefits From ERISA Investment Performance

A. Absence of Policy

The Hearings were replete with expressions that everything is for the best in this best of all possible worlds of ERISA.[16/] Expert witnesses testified that the funds with which they were familiar had all performed better than the "averages" and certainly well enough to yield a real return after taking inflation into account. The majority of the testimony was reminiscent of the trite phrase: "If it ain't broke, don't fix it."

Closer scrutiny of the testimony, however, brings to mind another analogy. The hearings were similar to the blind men who described an elephant solely from perceptions derived through touch. The conclusions set forth here are not meant to imply fault, for all the witnesses testified within their areas of expertise. None of the witnesses, however, is concerned with the whole system. Focusing on the specific

---

[16/] With the exception of Pete Harrison's experience with securing exemptions for certain real estate investments, no one of the witnesses expressed any concern about the adverse impact of the statute ERISA or the administration by OPWBP on their performance. This fact notwithstanding, one is left with the question of the extent to which the industry and DOL operate in ignorance of each other.

measurement of periodic investment results, it was clear from the testimony that there are exhaustive analyses of individual funds, but that no public material shows the results for a given plan in its entirety. This metaphor applies to the pension "industry" itself: an extraordinary concentration of talented professionals, each honestly convinced that the excellence of accomplishment from their perspective justifies a similar view of the entire field. Those surest that "it" doesn't need fixing have the least perspective as to what "it" is.

It is clear that very large sums of money are being invested in two legs of the "three-legged stool" of retirement income: savings and pensions. The legitimate question is whether the goal of providing retirement income is being achieved. Or, to return to our earlier idiom, what is the "it" that may or may not need to be fixed? In the words of one witness: "We still have no national consensus of such critical issues as what is the proper relationship among the parts of the so-called three legged-stool, employer-provided pensions, individual savings, and Social Security. What is adequate retirement income? What kind of vesting and portability is appropriate for today's mobile and diverse workforce? How should tax policy be used to encourage these retirement goals and, finally, who in government is in charge of this area?

"Without such a policy there is no context within which to adequately consider the issues of investment performance."[17] [emphasis added].

The fact is that ERISA's annual cost to the government is somewhat in excess of 43.2 billion dollars a year. The pension system is entirely voluntary; any company is free to have a scheme, or, once having one, to terminate it. This system has resulted in increasing numbers of plans, plan beneficiaries, vesting levels and total assets during the ten years of ERISA. Whether the results justify the cost is not known, since there are no policy objectives against which to measure performance.

In 1984, a member of the Council of Economic Advisors applauded the fact that there is no government "policy" regarding retirement income.[18] It is difficult to associate with this complacency in the absence of knowing essential facts; for example, what is the balance between savings and real pension holdings? To what extent should post-retirement income replace pre-retirement earings? Should tax incentives support post-retirement income above a certain level, either in dollars or as a percentage of earlier income? Is there a commitment to provide retirement benefits that are indexed against inflation? At the moment, the government permits vast latitude in allowing tax deductions for funding retirement schemes. Add to this the fact that there is no standard against which to judge investment performance. So all the interested parties have made up their own rules, and *mirabile dictu* everybody has won.[19/]

---

[17] Hearings, transcript, 1/9/85, Roger Bransford, p. 122.

[18] Senate Special Committee on Aging, Hearings on the Tenth Anniversary of ERISA, September 1984, testimony by William Niskanen.

B. Industry Prosperity

The underlying explanation[20/] for the confusion in pension investment management is very simply that the majority of the players are prospering and, quite understandably, wish to prolong a development that has brought about such a delightful set of circumstances.[21/]

[19/] Hearings, transcript, 1/9/85, Douglas Borton, p. 92. "...I feel it's not appropriate to set a nominal rate of return as an objective for a pension fund, although for calculation purposes we do have to set one for the purpose of the actuarial evaluation..."

[20/] To call it a rationale or a policy would be a hyperbole.

[21/] Hearings, transcript, 1/14/85, Lloyd McAdams, p. 66.
(Footnote Continued)

The Hearings were illuminating on several aspects of this prosperity that should be examined. They include the issues of real measurement of pension fund return; focus on short-term investment results; and conflicts of interest.

Performance measurement systems were discussed at great length during the Hearings, and testimony was unanimous on several points. Each measurement system is viewed as a marketing tool rather than a device for common communication. No measurement system consistently examined returns after expenses -- including management and transaction costs -- to say nothing of inflation. Indeed, there is no publicly available source of information with respect to the real rate of return achieved by pension funds.[22/]

(Footnote Continued)
"All of these industries have prospered dramatically since ERISA ...all of these industries have gone from rather slow industries to very aggressive, active industries which get a lot of attention and interest."

[22/] Hearings, transcript, 1/9/85, Professor Dennis Logue, p. 44. (Question from Monks) "Is there any publicly available information which would give a reliable answer on a true rate of return after expenses for pension funds?"
Professor Logue: "No."

None of the material provided at the Hearings purports to be definitive on the question of pension fund performance -- absolute or relative to indices, other institutions or inflation. The most illuminating material remains the articles of Dr. Roy Schotland, filed with the transcript of the Hearings, and Alicia Munnell, New England Economic Review (July/August 1983).

(Footnote Continued)

There seemed to be a consensus that professional standards for reporting performance are needed. In a hall full of self-proclaimed free enterprise advocates, there was surprisingly wide enthusiasm for the DOL to serve as a catalyst in developing such standards. Take, for example, the colloquy between OPWBP Chief Economist Dr. Richard Ippolito and Professor Logue:

IPPOLITO:. .[D]o you think that it would be advisable for the DOL to consider amending the annual 5500 reform [sic - report is meant] to require standardized reporting of rates of return?

PROFESSOR LOGUE: My general, philosophic view towards asking the government to do more is to say no. I am a member of the Mount Pelier (phonetic) Society. And from time to time we get a little riled up about the existence of traffic lights.

(Footnote Continued)

There was testimony by Dennis Tito that the TUCS system, now administered by Wilshire, contains performance data in consistent form for a substantial percentage of ERISA Master Trustees.

In this particular instance there seems to be substantial externality to the value of government data.[23]

Or consider the imprecation of Thomas Brophy: "I think that the industry desperately needs...some kind of cookie cutter that can be placed over the operation of funds as to the amount of money they start with, what the yield is, common estimate of risks that they're taking or not taking."[24]

Much of the agreement of need for a standardized investment performance reporting system subsumed the conclusion that it is generally beneficial for there to be public disclosure of as much pension fund administration information as possible. Specifically, it was suggested that the voting records of sponsors and managers be made public.[25]

---

[23] Hearings, transcript, 1/14/85, Professor Dennis Logue, p. 38.

[24] Hearings, transcript, 1/14/85, Thomas C. Brophy, p. 243. See also exchange between Deputy Administrator Lebowitz and Douglas Dorn, transcript, 1/15/85, p. 88, et seq.

[25] Hearings, transcript, 1/10/85, Dean LeBaron, p. 66. "Institutions can disclose their own voting practices." Hearings, transcript, 1/10/85, James E. Heard, p. 139.

As was evident by the range of witnesses at the Hearings, ERISA plans are ideal clients for brokerage houses, money managers, consultants, and professional advisors of all kinds. The resulting relationships encourage a short-term viewpoint[26/] that does not inure to the benefit of plan participants.[27/] With tax-insensitive holdings and continuing infusions of new cash, pension accounts may well be the single most important factor in accounting for the vastly increased trading in New York Stock Exchange securities. Yet no one at the Hearings could produce data showing a positive correlation between performance and the level of turnover in an account.[28/] Indeed, tax-exempt accounts have become such a large percentage of the total trading market as to cause concern over the level of expense incurred to service this volume.[29/]

[26/] Hearings, transcript, 1/14/85, Lloyd McAdams, pp. 65, 66. "Everyone has prospered."

Hearings, transcript, 1/14/85, Kenneth Cutler, p. 178. "Pension funds are the perfect client...they ought to outperform less fortunate competitors."

[27/] Ibid., pp. 65, 66 and 178.

[28/] Hearings, transcript, 1/14/85, Peter Dietz, p. 124. Peter Dietz said that he did not know of such study and that if he, personally, were able to prove the correlation, he would have published an article himself.

[29/] As another sidelight of "non policy," one wonders what has happened to non tax-aided savings. Is there any such thing? Has the massive impact of government subsidized

(Footnote Continued)

Finally, the vast and overlapping network of money managers and consultants tends to create major conflicts of interest among all of the significant participants in the ERISA system.[30/] Banks have "Chinese Walls" to regulate their trust departments; insurance companies have "separate accounts" for fiduciary funds; financial conglomerates have brokerage, consulting and money management subsidiaries. ERISA business is profitable for service providers. Thus, every effort is made to describe the scope of responsibilities narrowly and precisely so as to minimize the impact of legal inhibitions. The result is an aggregate of discrete professional services rather than coherent overall management.

(Footnote Continued)
retirement plans doomed individual efforts to provide for their own retirement security? Recent statistics are illuminating: the March 25, 1985 edition of Forbes reports that by April 15 of this year approximately $40 billion will have been invested in 1984 IRAs and Keoghs; at that time, approximately $140 billion will have accumulated in those two retirement schemes. The article notes that at least one expert says that these funds are set aside mostly by better-off people just putting the first $2,000 of their yearly savings into an IRA for the tax break. These accounts now constitute more than one quarter of individual savings in financial assets.

[30/] Hearings, transcript, 1/14/85, Professor David Ratner, p. 76, *et seq*.
Indeed, conflict of interest was described in the hearings as *the single* reason for poor investment results.

C. Risk-taking

The testimony of several senior ERISA experts was particularly illuminating. Pete Harrison has been the in-house manager for one of the more conspicuously successful private plans (Carnegie/U.S. Steel). In his remarks, Harrison noted: "My conclusion from 30 years in this field is very simple. You should drive as fast as you can, recognizing that snowballs will come through the windshield in July some years, that 13% government bonds will not totally protect an enterprise or its employees for their lifetime, that it is vital each month for the pension checks to clear the bank without your having to sell IBM at 57."[31] The current Chairman of Endowment Management & Research Corporation also stressed the certainty of violent change, even though there is uncertainty from which quarter it may come. He commented on the practice of taking advantage of high interest rates to "dedicate" portfolios: "An essential part of successful investment strategies is flexibility -- the ability to shift assets as prices, values, returns, conditions, and prospects change. Bond immunization denies that need."[32]

---

[31] Hearings, 1/9/85, written statement by Graham O. Harrison, p. 6.

The best strategy, therefore, for institutional investors generally is to have quick access to a different investment posture. But is this necessarily a correct posture for pension funds? Pension funds' needs can be simply stated: to provide at minimum risk a series of payments at known future intervals that will have purchasing power bearing an pre-determined relationship to salary levels then obtaining. It is clear that such a security exists in theory: an inflation-indexed U.S. Government bond.[33]

Witnesses' objections to indexed securities, whether indexed to inflation or to a market proxy (S & P or

---

[32] Hearings, 1/9/85, written statement by Peter Vermilye, p. 3.

[33] Introducing inflation considerations into investment policy for defined benefit plans is to ask the ultimate and most difficult question. With defined contribution plans, performance risk is all on the individual participants. With conventional defined benefit plans, the sponsor only obligates himself to make fixed payments. Over time, pensions have taken inflation into account by tying payment levels to final salaries. Almost no sponsors, however, have been willing to index payments to those already retired to inflation. An inflation-indexed security would permit this irrespective of the timing of an individual's retirement. The concept of an inflation-indexed security is posed as a "theoretical possiblity" against which to evaluate the risks and returns derived through conventional management.

Wilshire 5000), focused on several factors. Some, such as Harrison and Vermilye, believe that "... over time a minority of managers turn in consistently superior results."[34] The concept of the consistently superior manager is the stuff that maintains this hugely profitable industry.

If the definition of objectives has been accurately stated above, it is difficult to justify taking any risk beyond that necessary to achieve the stipulated goals. In other words, if the inflation-indexed government bond produces exactly the needed results, what excuse can there be to incur any risk to achieve results which are surplus, and therefore by definition not for the exclusive benefit of the plan participants? For whom is the manager managing? The statute and its exclusive benefit rule are unmistakable in stipulating that all plan assets must be held solely for the benefit of the participants. And yet the existence of pension plans is wholly voluntary. Any excesses above vested benefits can be returned to the corporate sponsor in the event that he in his uncontrolled discretion decides to terminate the plan. Many companies have, in fact, terminated their plans in recent months.

---

[34] Peter Vermilye, op. cit., p. 5.
Dean LeBaron alluded to the possibility that managers will have to develop new skills, to become active, to learn from the "corporate finance" departments in order to achieve acceptable results: "Finding the unique investment is not necessarily the only way in which one can achieve a target investment return. So institutions may develop some of these corporate skills...free market solutions are likely to arise quicker and probably better targeted than imposed solutions. And so the unbundling or the separation of the franchise, the equity or financial franchise from the control franchise...And there...you have an ideal setup for a market...high demand." Hearings, transcript, 1/10/85, Dean LeBaron, pp. 69-70.

There is an obvious conflict. As Professor Ratner put it: "...[T]he people who are managing the funds do not have the same interests as the beneficiaries of the funds."[35] The "wise men" want to invest pension funds prudently, as prudence has been defined in their other fiduciary incarnations. However, assuming the ERISA pension requirements can be met today by providing the legally required cash flows from government bonds,[36] does not a sponsor and possibly his delegated managers run the risk of surcharge for losses incurred by risks in excess of those necessary to achieve the plan's objectives? If the only use of excess funding is for return to the sponsor on termination, or as a reduction of immediate funding obligations by the sponsor,[37/] is there not an actionable conflict of interest in taking risks beyond those involved with a "dedicated bond portfolio?" The inflation-indexed U.S. bond doesn't exist, but the problem of conflict of interest bears substantial further attention. Note that the whole question only arises because there are no explicit policies -- no obligations with respect to percentage of pre-retirement pay or indexation. In this free world, everyone has the impression that their profit maximizing behaviour is in everybody else's best interest. It may just constitute an actionable conflict of interest.

---

[35] Hearings, transcript, 1/14/85, Professor David Ratner, p. 76.

[36] As mentioned earlier, the preponderance of "defined benefit plans" today does not require inflation adjustments. These liabilities can be offset with existing government bonds (government bonds are stipulated because they have the lowest risk).

Many of those testifying objected to indexing on the grounds that if everybody indexed, there would be no freely created market values any longer. Thus, the need for statistics becomes the operative consideration.[38/] A further concern relates to separating the fate of pension recipients from the rest of the economy. As Professor Scholes put it: "A government issuing a real rate bond with a real rate

---

[37/] Hearings, transcript, 1/14/85, Vernon S. Hodge, p. 254. "If the plan does well, the sponsor reduced his costs. If the plan does poorly, the sponsor increased his costs."

[38/] Hearings, transcript, 1/9/85, Professor Stephen A. Ross, p. 67, et seq.
Hearings, transcript, 1/14/85, Peter Dietz, p. 122.

guarantee could end up subsidizing pension funds."[39] There seemed to be no objection to inflation-indexed bonds from the point of view of achieving pension policy objectives.[40]

The unique characteristics of pension plans do not appear to have been taken into account. The assumption that risk/reward calculations suitable for other institutional investors are also suitable for pension plans has not been critically examined. The fact that investment performance of pension plans is less than optimal is at least in part attributable to failure to develop strategies (and securities) appropriate for their particular need.

---

[39] Professor Myron Scholes, op. cit., p. 154.
Hearings, transcript, 1/9/85, Sophie Korczyk, p. 169. "All taxpayers would wind up paying higher taxes to protect pension participants in the event of unexpected inflation."
Hearings, transcript, 1/9/85, Professor Marshall Blume, p. 51. "The government is essentially then guaranteeing the real productivity increases in the country."

[40] Professor Stephen A. Ross, op. cit., p. 5. Ross offers the following refinements: "While such [inflation-indexed] bonds offer protection against inflation, they exacerbate the real risks faced by the fund and simply don't address the other matters that should be of concern to pension funds. The risks faced by such funds extend beyond inflation to general questions of the business cycle and of real productivity. It is my view that pension fund investments should be structured so as to protect the fund, the beneficiaries, and the sponsors against undue exposure to these risks and ignoring them by investing in indexed bonds does not accomplish this. An employee with a defined contribution plan, for example, is not well served by an investment policy that in no way hedges against the risk of
(Footnote Continued)

VI. Fiduciary Responsibilities with Respect to Ownership

The structure of ERISA formally requires that a fiduciary take responsibility for trust assets. As mentioned above in section IV, the power to vote is an asset of the trust, and there was testimony on the point that voting power has financial value. Indeed, Dean LeBaron testified, "...it may be possible and desirable to unbundle the institutional proxy vote to rent it to the highest bidder in a market with controlled units, which is currently now being immobilized in the hands of rather passive institutions."[41]

There has been considerable academic discussion as to whether institutional shareholdings should be considered to possess traditional attributes of ownership, such as voting power.[42] Professor Auerbach furnished for the record "The

---

(Footnote Continued)
increased unemployment because of downturns in the business cycle."

[41] Dean LeBaron, op. cit., p. 66.

[42] Hearings, transcript, 1/10/85, David Heald, p. 110. "There are provisions that do not pass through to independent money managers the opportunity to vote. A lot of times the voting power still resides at the trustee level..." It is plainly the legal and commercial idiom in the United States that voting power with respect to shares of stock has appertained to their legal owners, be they institutional, or whether the voting power is delegated or retained.

Now and Future Business Corporation,"[43] his working paper which describes an entity that "...would have no 'owners,' and thus there would be an end to corporate attributes arising under that rubric...Shareholder approval...would become obsolete..." Writings associated with Professor George Lodge of the Harvard Business School describe a kind of "communatarianism" in which various corporate constituencies are involved in fundamental decisions, subsuming powers that by tradition were thought to appertain to the owners or shareholders. In so far as such speculation relates to securities held subject to ERISA it must, however, be considered moot.

"The power of the corporation is legitimized by the votes of the individual shareholders. Well it is a fiction, a legal fiction. It is a central part of the acceptance...of the economic tolerance of these units."[44] In hindsight, the impact of corporations in American life has been legitimized by the notion of a management supervised and constrained by an informed and involved cadre of owners. The owners, taking a leaf from Adam Smith's books, were the "public proxies" whose self interest coalesced through an "invisible hand" into the public interest. "The rights and responsibilities of stock ownership are inseparable from the rights to receive dividends and the fruits of retained earnings. Mindlessly voting with boards of directors on all issues is clearly a futile attempt to escape these responsibilities."[45]

---

[43] Professor Joseph Auerbach, remarks, April 30, 1983, Committee on Federal Regulation of Securities, Boston, MA. Furnished to Department of Labor as part of the Hearing Record 1/10/85.

[44] Hearings, transcript, 1/15/85, Professor Robert Soldofsky, p. 22.

The fact of the matter, however, is that while the trustee's responsibility may be clear, ERISA places a premium on delegation which creates confusion as to who actually exercises that responsibility. Voting shareholdings is problematic for several reasons: it is difficult to delegate; it is inconvenient for delegatees to exercise; and it creates conflicts of interest.

Professor Roger Murray articulated very precisely why the voting responsibility is singularly difficult to delegate to money managers:

---

[45] Hearings, 1/10/85, written statement by Professor Roger F. Murray, p. 1.

"The investment manager retains his clients and earns his fees by delivering good performance, which is measured against market indexes at frequent intervals. No plan sponsor adds to the performance measure points for thoughtful consideration of corporate governance issues. On the other hand, voting portfolio shares against the anti-takeover proposals of a present or prospective client is seldom perceived as the best way to cement or create a warm relationship. In short, the direction, if any, must come from the plan sponsor and it will eliminate the manager's conflict of interest problem."[46]

The voting right is also inconvenient: no one is paid for the work involved in exercising the franchise responsibility "prudently"; no one is protected against the liabilities that may arise from controversial votes (or the failure to vote); there is no schooling or professional background in "proprietorship"--most decisions are matters of first impression. Also, as mentioned above, the conflict of interest problem pertains to the extent that it appears unrealistic to expect intermediaries to be able to act effectively.[47]

---

[46] *Ibid*., p. 2.

[47] Dean LeBaron states that he had not felt customer pressure on account of his votes (See Dean LeBaron *op*. *cit*.,
(Footnote Continued)

The increase in size and relative importance of ERISA funds has exacerbated the conflict of interest problem. ESOPs are a case in point. Partly as a result of the Tax Reform Act of 1984, which provided significant tax advantages in using ESOPs, they have become "a sophisticated tool of corporate finance."[48] The role of ESOPs in takeover situations has been the subject of some judicial decisions to the effect that "...a corporate officer acting as a fiduciary of a defined benefit plan may not use the plan to acquire shares in the corporation for the purpose or resisting a tender offer." [49] There is vast confusion as to the relative priority of

---

(Footnote Continued)
p. 71). However, the written statement of Hillel Gray for the Investors' Responsibility Research Council (IRRC) contains a review of the experience of its entire clientele and concludes that the pressure on managers to approve charter changes is significant. Hearings, 1/10/85, written statement of Hillel Gray, p. 6.

David Heald, op. cit., pp. 103, 104. "We have had certain situations where there were apparent threats...suggesting to us that if we proceeded with our particular position they might want to find another commercial banking arrangement."

Hearings, transcript, 1/14/85, Richard C. Barker, p. 137, referred to a possibly adverse vote "where our chairman was solicited by the chairman of a company because he had learned...that we planned to vote against a package of anti-takeover resolutions."

[48] Hearings, 1/10/85, written statement of Alvin D. Lurie, p. 6.

[49] Hearings, 1/10/85, written statement by Frank Cummings, p. 3. (Cf. Donovan v. Bierwirth, 680 F. 2d 263, 271 (2d Cir. 1982) (suggesting that corporate officers who are also trustees of a plan may need to resign for the duration of a tender offer in order to avoid conflicts of interest)).

fiduciary duties as between corporate shareholders and fund beneficiaries. For example, former SEC Commissioner Bevis Longstreth was quoted to the effect that "...buyouts tend to put managements in the position of acting as both buyer and seller, and no fairness opinion, review by outside directors, or state or federal law can assure that public shareholders will be treated fairly" (emphasis added).[50] There has been no reconciliation of the policies that on one hand encourage retirement benefits independent of the future success of the company, and, on the other, profit sharing funds whose entire reason for being is to give participants "a share of the corporate gamble."[51] The Hearings did not focus on resolution of this specific problem; it is one of several side effects of the fact that a major portion of the nation's investment pool is held in a fiduciary capacity. There is the need to develop new institutions that can analyze these problems and formulate solutions.

In addition to the problems that delegation creates, recent developments have renewed focus on the exact extent of a trustee's responsibility to vote the shares of portfolio investments. Institutional investments generally, and ERISA plans specifically, continue to increase dramatically as a percentage of the total investments outstanding in the country. Projections are that ERISA plans will hold more than half of all the equity securities in the United States before the turn of the century. Perhaps not entirely by coincidence, take-over fever reached epidemic proportions in 1984. The causality may arise from the widespread conviction that fund managers and other fiduciaries are obligated to tender their shares to the highest cash bidder.[52/] The size of ERISA holdings cannot be ignored since the "institutions" are the indispensible participants in a successful take-over. Nor can the fact that their vote has value be ignored, because it is just this vote that has pivotal significance to a potential acquirer.

---

[50] James E. Heard, op. cit., p. 4.

[51] Frank Cummings, op. cit., p. 6.

To appreciate the importance of institutions exercising their franchise, consider the situation if they do not act. Power is then conferred on other elements in the corporate

---

[52/] Peter F. Drucker published a widely read editorial in the Wall Street Journal to this effect in November 1984. Peter Vermilye comments: "We share with Peter Drucker the concern that the take-over mania has gone too far. It has gone beyond the desirable objectives of reallocating capital to more productive uses. It is at times counterproductive to buy out major companies at huge premiums with borrowed funds. We agree with [the Administrator of the Office of Pension and Welfare Benefit Programs] that it is not always in the best long term interest of stockholders to sell out well managed companies."Peter Vermilye, *op. cit.*, p. 3.

power balance far beyond that which is appropriate. Thus, managements and small active shareholders have in effect been "given" control over corporations by institutions refusing to be inconvenienced by exercising unwanted rights. "But they cannot avoid exercising that power, either directly or by default. They have the votes and if they don't do it, someone else would do it. It is the classical dilemma..."[53]

Professor Joseph Auerbach agonized over this problem by hueing precisely to the trustee's sole responsibility to his beneficiary. While elaborating on the requirement of trustee supervision of portfolio companies, he recommended against transitive activity by the trustee on the grounds that it would inevitably distract from the trustee's duty to preserve trust assets. "I don't know how to be both an owner-manager and a fiduciary-trustee for people's benefits. I don't know how to do it. I can't ever find myself able to be wholly objective... Am I now -- now that I am controlling the corporation -- am I now making this decision for the benefit of the beneficiaries? Am I making it for my benefit? Am I making it for the benefit of the community?...and the only way that I know...of facing up to this problem is to say I only have one master. I only have one function."[54] This probably is as near as we'll get to a definitive statement of the weighing of the different aspects of the trustee's obligation to his beneficiary. It leaves unanswered the obverse part of the problem: while the trustee's pristinity is preserved, who will take responsibility for the adverse effect on trust holdings? Possibly, in Auerbach's Ockham-like analysis is the birth of the notion of a yet undefined institution to exercise franchise power for trust holdings. If the trustee cannot do it, and if it must be done in order to preserve the value of trust assets, then some formal process must be devised to effect the desired goal.

---

[53] Professor Robert Soldofsky, op. cit., p. 25.

Although a detailed consideration was well beyond the scope of these Hearings, witnesses described new institutions that intended to consider more active exercise of their rights. Jesse Unruh, State Treasurer of California, described the formation of a group of public funds to consider areas of mutual interest with respect to their rights in portfolio investments.[55] Public funds are largely immune from the potential conflicts of interest and other restraints that temper whatever activist instincts exist among ERISA managers.[56] It should be noted that in the past, political pressures have been brought to bear on state officials having voting powers, and that the provisions of ERISA do not apply to public plans.

---

[54] Hearings, transcript, 1/10/85, Professor Joseph Auerbach, pp. 211, 212.

Peter Vermilye, op. cit., p. 51.

Professor Roger Murray, op. cit., p. 82. "The institutional investor is not investing in order to ...direct the internal affairs of the corporate entity."

The nature and limits of fiduciary obligation were spelled out by Professor Auerbach, and they illustrate why new guidelines for action are needed. On the one hand, he wrote, "Shareholders must protect themselves...against erosion of protective charter provisions"; on the other, he counselled that a "Fiduciary must remain unencumbered...[neither] control [n]or participation in new management...is an appropriate objective."[57] Auerbach conceives of a fiduciary model in which the fiduciary is solely concerned with preservation of the value of the trust asset and does not permit his attention to be diverted by such peripheral issues as conducting a law suit, planning to acquire control, or participating in running the company. This model requires uncompromising attention to and protection of the full franchise rights to which stock ownership entitles the trust.

---

[55] Hearings, 1/15/85, written statement by Jessie Unruh, p. 2.

[56] James E. Heard, *op. cit.*, p. 9.

[57] Professor Joseph Auerbach, *op. cit.*, pp. 3, 5.

Hugh Calkins testified that, "Directors who consider that their fiduciary obligation runs to the owners of a stake in corporate America will take a different view of some questions than directors who consider that their obligation runs to a fluid group of short-term speculators in the shares of a single corporation. The broader view may not be sounder, but it should be given more consideration than under present practice..."[58/] The ERISA fiduciary is literally a universal shareholder. Typically, he will own shares in all the companies that are parties to a complex transaction. "Institutional investors who own interests in the buyer, the seller, the supplier, and the customer have a different view of such major transactions than a holder of shares in only one of the participants."[59/] Many legal and operational questions need to be addressed. No one really knows the extent to which it is appropriate for fiduciaries to consult with each other, but it is clear that the process must begin.

[58/] Hearings, 1/10/85, written statement by Hugh Calkins, p. 20.

[59/] *Ibid*, p. 19.

This summary earlier noted the concept of separating franchise from economic rights in shares of stock. For reasons mentioned above, substantial testimony indicated that it would seem preferable for the plan sponsors to retain the voting rights. "Direction, if any, must come from the plan sponsor and it will eliminate the manager's conflict of interest problem."[60] In addition to Dean LeBaron's imaginative reference to selling voting rights to the highest bidders, two specific proposals were made in the course of the Hearings as to how the sponsor might exercise his franchise responsibilities. Neither idea is new. Professor Soldofsky first publicly proposed "structured differentiation" in the early seventies. "...I see that there would be great merit in separating the vote and control because then you could set up an important organization which would represent all interests in the society, the institutions, the individual shareholders, the state and local pension funds."[61] Soldofsky envisages an institution along the lines of the Federal Reserve, that would have public and private directors. Professor Murray draws on his long experience as an "outside" mutual fund director and principal in TIAA/CREF to suggest that the sponsors' Board of Directors "...recruit a panel of knowledgeable and independent individuals to provide advice on the policies to be established. This Advisory Panel on Corporate Governance Issues could have a Secretary drawn from the staff to gather information from portfolio companies and investment managers."[62]

---

[60] Professor Roger Murray, op. cit., p. 2.

[61] Professor Robert M. Soldofsky, op. cit., p. 29.

While this testimony does not converge on a single recommendation regarding the exact form a new institution might take, it was clear that many witnesses thought such an entity would be desirable.

VII. Summary

As is evident, the testimony covered a broad range of topics and viewpoints. There was consensus, however, on the importance of several concerns:

A. Cost-Benefit

It was noted above that the annual cost of ERISA in foregone revenue is 43.2 billion dollars. There are two obstacles to measuring the Act's benefits. One is the absence of timely and complete plan data given the current paper-based filing system for annual reports (Form 5500 reports). In 1984, OPWBP conducted a highly successful pilot project that tested the electronic submission of ERISA data (e.g., by computer tape or diskette). The transition to an electronic system is crucial if timely data on ERISA plans and their assets is ever to be available to public and private sector analysts and decisionmakers. Without such data, there is no practical way to compare benefits to costs.

---

[62] Professor Roger Murray, *op. cit.*, p. 4.

The second obstacle is the absence of retirement income security policy that focuses on accomplishment of measurable objectives. ERISA simply encourages "activity" -- the activity engendered by successive delegating, by hiring managers, consultants and experts, by boosting service providers' fees with no eye to their value to plan beneficiaries. None of this activity necessarily promotes the social policy objectives implied by a law that promotes and protects retirement income.

B. Voting Responsibilities

As testimony made clear, the question of corporate governance is growing in importance as the size of ERISA assets grows. Multi-layered delegation of responsibility not only dilutes the sponsor's perception of his duties, but obviously increases the potential for major conflicts of interest among the delegatees. Recent take-over activity has further illuminated the potential for mischief in cases where votes are solicited for defensive measures. While the Hearings yielded only anecdotal material regarding pressure brought to bear on money managers, it served as evidence of the conflicting loyalties that can influence fiduciary behavior.

As one witness noted, the interests of those who manage ERISA funds are not the same as the interests of the beneficiaries; in the end, it is the plan sponsor who is responsible for protecting the beneficiaries' assets, one of which is the right to vote. The sponsor, by process of elimination, emerges as the one party in the ERISA system who is least encumbered to exercise that right consistently and thoughtfully. There was nearly unanimous agreement in the Hearings that plan sponsors must assume a more proprietary role in voting plan shares. Further, there was interest shown in exploring new institutions that might be used to insulate the voting function from conflicts of interest.

C. ERISA Data Management

As mentioned above in (A), the establishment of a computerized data base for ERISA annual reports is vital to informed decisionmaking. All the issues discussed in the Hearings turn on information; if ERISA is to be evaluated as a major component of public policy regarding retirement income, the agencies that administer it must have access to current plan statistics.

D. Performance Measurement

Witnesses were surprisingly candid in their comments that a) to the extent they exist, performance data are used merely as a marketing tool, not as objective indicators; and b) that competitive market forces will always discourage the establishment of uniform objective performance standards. Surprisingly, the feeling was that in this instance, the Federal Government is uniquely positioned to assist in establishing such standards. DOL was urged to act as a convenor in starting the process of standard-setting.

E. Fiduciaries' Exercise of Voting Rights

There appears to be uniform public confusion about the Department's view of the extent to which ERISA permits the pass-through of voting rights to participants in plans that hold employer stock. This question has become particularly significant given the widespread popularity of ESOPs, and other stock ownership plans, and their pivotal nature in determining the outcome of tender offers and other corporate machinations. The Department should consider promulgating regulations that define the scope of a plan fiduciary's responsibility to exercise the voting rights of employer securities held in ERISA plans, even in situations where the plan purports to pass through the voting power to participants. These regulations would necessarily include an interpretation of Section 404(c) of ERISA as well as Section 403(a).

F. Self-Regulatory Organization(s)

The essential nature of the ERISA statute is cooperative, not adversarial. The very fact of their willingness to testify augmented many witnesses' statements that common, thorough understanding of the law is a worthwhile objective. The Department was applauded for holding an open discussion of fund performance and corporate governance, and it was clear that witnesses saw the Hearings as a joint contribution to improved understanding of the issues.[63/]

[63/] Hearings, transcript, 1/9/85, Theodore M. Theodore, p. 131. Mr. Theodore expressed concern over whether "...Labor [is] trying to protect pensioners from Wall Street." The Administrator assured him personally and for the Department that the purpose of the Hearings was informational and the policy of the Department was to develop private sector mechanisms rather than to expand government's role.

There is no precedent for the massive investment network that ERISA covers, nor for the rate at which financial markets become increasingly sophisticated and complex. The need for ERISA constituents to respond to these dynamics has grown commensurately. It is DOL's aim to help meet this need cooperatively, not in an obstructionist manner. It is evident that an enhanced partnership of public-private sector experts can assist in this effort.

One model for such a partnership, which was discussed in the Hearings,[64/] is a self-regulatory organization (SRO). The Department has spent a great deal of time researching this concept, and studying other SROs (the

---

[64/] Hearings, transcript, 1/9/85, Sophie Korczyk, p. 172: "Exemptions, as we know, can take many years to process... Private sector input in this process could expedite the...exemptions, as an SRO could draw directly on experts in the affected industry to determine the validity of a specific request...

"At the same time, if such an organization were modeled on existing organizations, like the Financial Accounting Standards Board and the National Association of Securities Dealers, the organization would not be able to approve all applications indiscriminately, as the Department would retain final jurisdiction..."

See also the exchange between Ms. Korczyk and DOL Solicitor Francis Lilly, ibid, pp. 180-181.

Solicitor Lilly: "Do you think that the pension industry would use [an SRO]?"

Ms. Korczyk: "...I would tend to guess yes...The Financial Accounting Standards Board is certainly feared every bit as much as the IRS or any other arm of government, and so I think it would be used."

National Association of Securities Dealers and Financial Accounting Standards Board). There are many possible roles for such an organization; it could assist in the ERISA prohibited transaction exemption process, and conceivably serve as a forum for the discussion of key issues such as those addressed in the Hearings. It might also convene parties to deliberations like the performance measurement standard sought by witnesses. DOL should be receptive to initiatives by the private sector to explore the creation of an SRO.

Mr. CLAY. Thank you.

Next.

Mr. GRUBBS. Mr. Chairman, my name is Donald Grubbs. I am an actuary and an attorney and have been working with private pension plans for about 30 years. I manage the Washington office of George Buck Consulting Actuaries, but my views are solely my own personal views.

My written testimony discusses vesting, portability, and integration of pension plans with Social Security, along with some closely related topics. In these brief moments, I can only touch the highlights of that written testimony which has some detail, and I would like to refer to the summary of my principal recommendations which are found beginning on page 49 of my testimony.

The following measures are recommended: One, prevent any reduction in Social Security cost-of-living adjustments. Two, require full vesting after 3 years of service for all private pension plans. Three, forbid lump sum distributions from plans, with certain appropriate exceptions, since lump sum distributions disperse pension plan assets and take away the flow of income after retirement. Four, establish a portable pension system, composed of modified IRA's, a Federal portable pension fund, and a Federal portable pension clearinghouse. This is described in detail in my written testimony.

Five, revise the requirements for integration of private pension plans with Social Security to make them fairer, simpler, current, and to meet the needs of lower income workers. This is discussed in detail in the testimony.

In addition to these five basic recommendations, my testimony presents two related recommendations. First, that the dollar limits on benefits and contributions in plans, which are found in section 415 of the code, be eliminated so there would be no dollar limits, only percentage limits. Second, that all top-heavy plan requirements should be eliminated by deleting section 416 of the code.

These changes will assure that American workers accrue pension benefits more fairly; that more of the accrued pension benefits will be preserved to provide income and retirement, and that the administrative burden and administrative expense for plan sponsors will be reduced.

I would like to use my few remaining moments to discuss the relation of Social Security to vesting, portability, and integration, which discussion is found beginning on page 2 of my testimony.

Social Security is the foundation of retirement income security in America. Only about half of all active workers covered under Social Security are covered under any private pension plan. The majority of retirees now receiving Social Security do not receive any private pension.

Integration of private pension plans is obviously based on the foundation of Social Security. Social Security is also the foundation of vesting, since Social Security bases benefits on a worker's earnings with all employers, and provides the same pension to a worker who changes jobs frequently as one who has the same earnings, but with a single employer, a feat private pensions cannot fully match. Social Security is also the foundation of portability, since it alone pays a single pension from a single source based on service with all employers.

This is not to denigrate the very valuable role that private pension plans play in supplementing Social Security for many workers. We need to strengthen that role.

At the same time, we must guard against any effort to undermine the foundation provided by Social Security. Inflation clearly undermines private pensions, making fixed pensions purchase less every year. The pension that buys less groceries every year is only partially nonforfeitable. For many years, Social Security has provided retired workers with pensions that are truly nonforfeitable, with cost-of-living adjustments that prevent the purchasing power from being forfeited through inflation. Now some would take away the cost-of-living adjustment. To eliminate the cost-of-living adjustment in a year of 5-percent inflation has exactly the same effect as actually reducing the pensions 5 percent in a year when there is no inflation. This would reduce the standard of living of retired workers.

In 1983, Congress strengthened Social Security so that the scheduled taxes are now expected to be sufficient to pay the promised benefits. There is no need to reduce cost-of-living adjustments to solve any financial problem of Social Security since there is no such problem. Then why is it proposed to reduce Social Security benefits? The alleged purpose is to reduce the budget deficit, but Social Security is funded under separate trust funds. Not one dime saved under Social Security can be used to pay other Federal expenses.

Any changes in Social Security, like the 1983 amendments, should be in response to the long-term needs of Social Security, not the year-to-year budget problems. Some would justify Social Security cutbacks by saying that retirees should share in budgeting cutbacks. This comes at a time when America is pulling out of its economic problems, and when the wages of active workers are generally keeping up with inflation. Recent and proposed cutbacks in Government expenditures have hurt retirees at least as much as younger people. To cut their Social Security benefits at the same time would be unfair. Congress should not chip away at the foundation of retirement income security.

Social Security and private pensions must be viewed as parts of a combined approach in providing retirement income security. But only Social Security provides full vesting and portability. Since that is so, any cutback in Social Security must be viewed as a cutback in vesting and portability of the combination and would create a need to increase the integrated private plans designed to supplement Social Security. Thank you.

[The prepared statement of Donald Grubbs follows:]

VESTING, PORTABILITY AND INTEGRATION WITH SOCIAL SECURITY UNDER PRIVATE PENSION PLANS

BY
DONALD S. GRUBBS, JR., F.S.A.
CONSULTING ACTUARY

GEORGE B. BUCK CONSULTING ACTUARIES, INC.

PRESENTED TO

SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS
COMMITTEE ON EDUCATION AND LABOR

UNITED STATES HOUSE OF REPRESENTATIVES

APRIL 2, 1985

A. Introduction

This presents proposed solutions to the problems of vesting, portability and integration of pension plan benefits with social security. The viewpoints presented are solely those of the individual author.

Because Social Security is closely linked with all three topics, it is addressed first, followed by sections discussing solutions to the problems of vesting, portability and social security. These are followed by sections discussing how the proposed solutions would affect the existing limitations on benefits and contributions (Code section 415) and rules for top-heavy plans (Code section 416). The final section summarizes my conclusions.

B. The Foundation: Social Security

Social Security is the foundation of retirement income security in America. Only about half of all active workers covered under social security are covered under any private pension plan. The majority of retirees now receiving social security do not receive any private pension.

Integration of private pension plans is obviously based upon the foundation of social security. Social security is also the foundation of vesting, since social security bases benefits on a worker's earnings with all employers and provides the same pension to a worker who changes jobs frequently as one who has the same earnings but with a single employer, a feat private pensions cannot fully match. Social security is also the foundation of portability, since it alone pays a single pension from a single source, based on service with all employers.

This is not to denigrate the very valuable role that private pension plans play in supplementing social security for many workers. We need to strengthen that role. But at the same time we must guard against any effort to undermine the foundation provided by social security.

Inflation clearly undermines private pensions, making fixed pensions purchase less each year. A pension that buys less groceries every year is only partially nonforfeitable.

For many years social security has provided retired workers with pensions that are truly nonforfeitable, with cost-of-living adjustments that prevent the purchasing power from being forfeited through inflation. Now some would take away the cost-of-living adjustment. To eliminate the cost-of-living adjustment in a year of 5% inflation has exactly the same effect as to actually reduce benefits 5% when there is no inflation. This would reduce the standard of living of retired workers.

In 1983 Congress strengthened social security, so that the scheduled taxes are now expected to be sufficient to provide the promised benefits. Thus there is no need to reduce cost-of-living adjustments to solve any financial problem of social security, since there is no such problem.

Then why is it proposed to reduce social security benefits? The alleged purpose is to reduce the budget deficit. But social security is funded under separate trust funds. Not one dime saved under social security can be used to pay for other federal expenses. Any changes in social security, like the 1983 amendments, should be in response to the long term needs of social security, not the year-to-year budget problems.

Some would justify social security cutbacks by saying that retirees should share in the budgeting cutbacks. This comes at a time when America is pulling out of its economic problems and when the wages of active workers are generally keeping up with inflation. Recent and proposed budget cutbacks in government expenditures have hurt retirees at least as much as younger people. To cut their social security benefits at the same time would be unfair.

Congress should not chip away at the foundation of retirement income security.

Social security and private pensions must be viewed as parts of a combined approach to providing retirement income security. Since only social security provides full vesting and portability, any cutback in social security must be viewed as a cutback in the vesting and portability of the combination, and would create a need to increase the integrated private pension plans designed to supplement social security.

C. Earlier Vesting Requirements

1. Background

The words "vested" and "nonforfeitable" are generally used interchangeably. They describe a right to an accrued pension benefit that cannot be forfeited by termination of employment.

ERISA required all plans to provide accrued benefits under one of the three alternative requirements:

(1) 100% vesting after 10 years of service

(2) 25% vesting after 5 years of service, graded up to 100% after 15 years of service

(3) graded vesting under the "Rule of 45"

Defined benefit pension plans that cover the majority of employees have chosen 100% 10 year vesting, since graded vesting is more difficult to communicate and administer, particularly because of required "buyback" provisions that apply to plans with graded vesting. Some plans have earlier vesting than required. Most defined contribution plans have vesting earlier than 10 years, including some plans with 100% immediate vesting.

TEFRA required "top-heavy" plans (most small plans) to provide either 100% vesting after 3 years of service, or 20% vesting after 2 years of service graded up to 100% after 6 years of service.

2. The Need for Earlier Vesting Requirements

Many employees never stay with any employer for the 10 years now required for vesting under the plans covering most participants. The loss of pensions is particularly acute for women, who commonly have shorter periods of service than men.

The worker who changes jobs frequently will have as great a need for retirement income as the worker who stays with a single employer all of his working career. Because of lack of vesting the worker who changes jobs may receive no pension at all, or only a small pension based upon service with the worker's last employer.

Some have suggested that 100% vesting be required under all plans after 5 years of service, or after 3 years of service. Some propose immediate vesting, at least with respect to some minimum level of benefits, since this is the only way to protect all pension benefits earned.

3. Cost of Earlier Vesting

Earlier vesting increases the cost of pension plans. At the request of Congressional committees, I conducted a detailed study of the cost of mandatory vesting provisions* being considered when ERISA was developed.

These studies indicate that requiring full vesting after 5 years of service for plans already subject to ERISA's requirements would create increases in cost for most defined benefit pension plans ranging from 0% to 7% of present plan costs and from 0.0% to 0.2% of compensation of covered employees.

Studies based on current data would probably produce similar results. 3-year vesting would be more expensive than 5-year vesting. Consistent with my previous studies, I estimate that 3-year vesting would create increases in cost for most defined benefit plans ranging from 0% to 10% of present plan costs and from 0.0% to 0.3% of compensation of covered employees.

Any increases in cost are undesirable. But the cost increase is small and affordable, and this disadvantage is outweighed by the need for earlier vesting. If necessary, the increased cost could be absorbed through slightly lower (0.0% to 0.3%) wage increases in one year, a worthwhile trade-off when one considers the present imbalance between income during working years and income after retirement for workers with no vested pensions.

---

*Study of the Cost of Mandatory Vesting Provisions Proposed for Private Pension Plans, prepared for the Subcommittee of Labor, U.S. Senate, USGPO 88-610 O, 1973.

4. De Minimis Benefits

Some argue that vested benefits after very short periods of service are too small to be useful in meeting retirement needs, and that the cost of preserving and administering them is relatively large in proportion to the benefits.

Small vested benefits are often paid off in a lump sum and spent, rather that being preserved to provide retirement income. To the extent this occurs, earlier vesting does not accomplish the goal of meeting retirement income needs better. This relates to questions of portability discussed in the next section. Some advocate correcting this problem by requiring plans to preserve benefits for retirement needs rather than paying lump sums, but this would increase the administrative burdens on plan sponsors. The solution to these problems is improved portability, discussed in the next section.

5. Full Vesting Standard or Graded Vesting Standard

ERISA gave plan sponsors a choice between 100% full vesting after 10 years of service or two alternative graded vesting schedules. One requires 25% vesting after 5 years of service, graded up to 100% after 15 years. The second alternative, called the "rule of 45", bases vesting percentage on a combination of age and service. Each one of these three alternatives is better than the other two for certain employees and worse for other employees, depending on age at hire and years of service. Studies show that typically the aggregate amount of benefits provided and the cost of benefits are virtually identical for the three schedules. Yet plan sponsors have overwhelmingly found that the 10-year full vesting schedule is easier and less costly to administer, and easier for employees to understand.

Ease and cost of administration and ease of communication are important considerations. Therefore no new standard should impose graded vesting on plans.

6. Class Year Vesting

Some defined contribution plans have class year vesting, and this alternative is permitted under ERISA. Under class year vesting each year's contributions are placed in a separate class. Each class must be vested at the end of the fifth plan year after it was established. A participant is not required to be vested in the contributions of his five most recent years until he reaches retirement age, even if he has 30 or more years of service.

Class year vesting is designed to penalize employees who terminate employment before retirement age, in order to discourage turnover. Such a penalty concept is fundamentally counter to the purpose of vesting, which is to assure that earned pensions will not be lost. This class year exception to the regular vesting requirements should be eliminated.

7. Earlier Vesting to Prevent Discrimination

Internal Revenue Code section 411(d)(1) allows IRS to require earlier vesting than the usual standards in two circumstances.

Subparagraph (A) allows IRS to require earlier vesting if "there has been a pattern of abuse under the plan (such as a dismissal of employees before their accrued benefits become nonforfeitable) tending to discriminate in favor of employees who are officers, shareholders or highly compensated." Fortunately such abusive practice is rare, but there can be no question but that earlier vesting should be required in such circumstances.

Subparagraph (B) allows IRS to require earlier vesting if "there have been, or there is reason to believe there will be, an accrual of benefits or forfeitures tending to discriminate in favor of employees who are officers, shareholders, or highly compensated." ERISA's legislative history is clear that this earlier vesting was to be required in exceptional cases and not in most plans, and that even then the IRS should not require vesting more rapid than 40% after 4 years increasing to 100% after 11 years. However the vagueness of the statutory language has resulted in a great disparity of treatment by IRS from district to district. In some districts "likely to believe there will be" has been read with paranoid eyes that believe all small plans are likely to discriminate. The arbitrary implementation of subparagraph (B) by the IRS has created great uncertainty for plans.

TEFRA's 1982 addition of earlier vesting requirements for top-heavy plans reduced the chance that a plan's vesting provisions would result in discrimination. If Congress now decides that earlier vesting should be required for all plans, whatever need originally existed for subparagraph (B) would no longer exist. Therefore subparagraph (B) should be deleted. Subparagraph (A) should be retained to give IRS authority to require earlier vesting in case of actual abuse.

8. Special Considerations for Multiemployer Plans

Some have suggested that those multiemployer plans that cover virtually all workers in an industry, or collections of multiemployer plans with reciprocity agreements, do not need earlier vesting, since these plans already provide portability for those who change jobs within the industry. But such plans clearly do not protect workers who take jobs outside the industry. Particularly in a declining industry, workers may be laid off and have no choice but to seek work outside the industry. Thus participants in multiemployer plans need earlier vesting as much as participants in other plans.

Nevertheless, I recognize that consideration is being given to providing an exception to earlier vesting for certain multiemployer plans. One exception that some have suggested would exempt multiemployer plans of national or international unions which cover all members of the union. To my knowledge no such plan exists.

The second exception suggested by some would exempt any multiemployer plan that has a certain type of reciprocity agreement with every other multiemployer plan covering members of the same international union. I think it would be quite difficult for a local Teamsters plan to even find all of the other Teamster plans in the United States; and those who think that a local plan could then get each of the other plans to agree to reciprocity agreements haven't sat through too many trustee meetings of small plans discussing reciprocity agreements. Reciprocity agreements are developed between plans which have a number of employees moving from one plan to another. In the building trades it is common to have a reciprocity agreement with the plan in the next county. But a plan in New York might think it a waste of plan assets to entail the expense of negotiating a reciprocity agreement with a plan in Nevada, since its members don't go to Nevada to work.

An exception from earlier vesting might be given to those financially troubled multiemployer plans that are in reorganization. Because participants in multiemployer plans need earlier vesting, no other exception should be made for multiemployer plans. But to ease the problems of adjustment to the slightly increased costs, and perhaps as a compromise if one is needed, a longer deferral of effective dates for multiemployer plans might be granted during periods in which the plans make no benefit increases. If a plan can afford to make benefit increases, it can also afford earlier vesting, and no deferral should apply.

Another special consideration for multiemployer plans is that earlier vesting would increase the withdrawal liability for withdrawing employers. To prevent this, the withdrawal liability provisions could limit the value of benefits for this purpose to exclude benefits for participants with less than 10 years of service who are not yet retired or eligible for retirement.

10. Summary of Recommendations

(1) 100% vesting after 3 years of service should be required for all plans.

(2) Delete Code section 411(d)(1)(B), which now allows IRS to arbitrarily require earlier vesting.

(3) An exception to earlier vesting should be allowed for multiemployer plans in reorganization.

(4) If needed for multiemployer plans, a deferral of the regular effective dates might be considered for periods during which no benefit increase is made.

D. Portability

Portability is the ability to transfer an individual's vested pension credits to a succeeding plan, IRA or central clearinghouse upon termination of employment. There is presently very little portability among private pension plans.*

1. The Need for Portability

In the past it was suggested that portability did not really matter if vesting provisions were adequate. Does it really matter whether a worker receives four small vested pensions from four employers instead of receiving one combined pension from a single source? But, as explained below, the lack of portability often causes the individual to receive less retirement income.

Any employer faces a practical problem in trying to administer small vested pensions for the terminated employee. The problems of keeping records of the small pension, of keeping track of the former employee over many years, of sending the terminated vested employee summary annual reports and notices about plan changes, of locating him when benefits become payable, make the administrative costs high in relation to the amount of the benefit.

ERISA provides needed relief to the employer or other plan sponsor, from the disproportionately high administrative costs for small vested pensions. However this relief works to the detriment of the terminating employee. Under ERISA a pension plan may "cash-out" the employee's vested benefits in a lump sum upon termination of employment. Lump-sum distributions over $3,500 can only be made with the employee's consent. However, employees are tempted to accept the amounts offered so that they may gain discretionary use over them.

---

*"Study of Analysis of Portability and Reciprocity in Single Employer Pension Plans", prepared under the supervision of D.S. Grubbs, Jr., under Contract J-9-P-8-0191 between the U.S. Department of Labor and George B. Buck Consulting Actuaries, Inc.

IRAs coupled with the rollover provision provide portability for the employee who wants to use them, but most individuals receiving lump-sum distributions spend them rather than rolling them over into an IRA for retirement income purposes. This is particularly true of lower income workers with the greatest need for a pension in their later years. Even if the amounts are rolled-over into an IRA, an individual can still draw upon the IRA prior to retirement, although there are tax penalties to discourage premature withdrawals.

2. Solutions to the Problem

The fundamental problem stems from amounts that plans pay as a lump sum distribution. These amounts may be entirely spent, leaving the participant with no pension.

One approach to portability would be to allow plans to deposit amounts otherwise payable as a lump sum directly into a special kind of rollover IRA that would deny access until retirement age and then require an annuity payout. Alternatively a federal portable pension fund could be established with individual interest-bearing accounts to receive each participant's transfer, preserving the benefits for the employee while still avoiding the administrative burden upon the employer. Another approach could provide for both these alternatives.

A more effective approach would be to combine the provision of such portability vehicles with a rule forbidding plans from paying lump sums directly to participants. Appropriate exceptions to this requirement are discussed later.

In the absence of mandatory rollover IRAs or a central portability fund, many employers will very naturally pay the vested amounts in a lump sum directly to the terminating employee, who spends the money and then has no pension.

3. Pay-Out in a Lump Sum, Installments or a Life Annuity

At retirement, should a participant's account balance be paid as a lump sum, as a series of installments over a period of years, or as an annuity payable for life? The purpose of a portable pension system is to preserve, for the purpose of providing an adequate retirement income, the amounts that would otherwise be cashed-out. Amounts paid as a lump sum may be spent immediately or lost in unwise investments, leaving the participant to live in poverty in his old age. If payments are made over a fixed period of years, the retiree may outlive the installments and have no income in later years. Therefore the account balance should be used to provide a retirement income which continues for the lifetime of the participant and should not be paid out in a lump sum or in installments for a fixed period. When the participant is eligible to receive retirement benefits, his entire account balance should be applied to provide him an annuity which continues for at least the lifetime of the participant, or the combined lifetimes of the participant and his spouse.

4. Exception to Forbidding Lump Sum Distributions

It is recommended that plans generally be forbidden from paying lump sum distributions, since these payments destroy pensions, leaving workers without retirement income. But two exceptions should be considered.

First, a grandfather clause is needed to protect the expectations related to benefits already accrued. Thus lump sums should be allowed with respect to benefits accrued before the portability effective date, if the plan already allows lump sums. For participants already close to retirement age on the effective date, perhaps this exception should be extended to the entire accrued benefit .

Second, consideration could be given to an exception where the employer maintains two plans, one designed to provide pensions and a second designed to provide supplemental amounts. An exception could be allowed for the second plan if the first plan provides at least some minimum level of benefits or contributions.

5. Mandatory Transfers from Defined Benefit Pension Plans

I have advocated that plans be permitted to transfer the value of vested benefits to a portability system, and also that lump sum distributions generally be forbidden.

Some want to go further than this. They want to require that a transfer be made at the time each person terminates employment. This proposal has several serious problems for participants in defined benefit plans.

First is the question of whether the transfer will produce more or less income under the portability system than under the original pension plan. For example, assume that John Doe terminates employment at age 35 and is entitled to a pension of $100 monthly beginning at age 65. The pension plan determines the present value of John Doe's pension, discounting it for interest. The plan may use an interest rate that reasonably represents the interest that the fund would expect to earn on the money. This amount could be transferred to a portability fund, where it could grow with interest and be used to provide a pension at retirement age. Ignoring for the moment the effect of the mortality discount and death benefits, if the portability fund actually earns the same rate of interest that was assumed in determining the amount of the lump sum, the amount of income from the portability fund would be exactly the same as the amount that would have been provided under the pension plan. The amount of income from the portability fund would tend to actually be more or less than this amount, depending on whether the interest actually earned by the portability fund is more or less than the interest rate used for determining the lump sum. Those who would mandate pay-outs from the pension plan hope to provide larger pensions in order to overcome the depletion of vested pensions by inflation. Unfortunately the proposal is unlikely to accomplish the goal.

Some plans now use unrealistically conservative interest rates to determine the amount of lump sum distributions, which are usually paid only to participants who terminate with very small vested pensions valued at less than $3,500. Such conservative rates generously represent more than the pension plan's cost of providing the deferred pension. Where such conservative rates are used to determine lump sum amounts, the portability fund can be expected to provide more monthly income than the pension plan would have paid. But if such plans are required to pay lump sum distributions upon all terminations, rather than only the small amounts now paid, many could be expected to change to a realistic interest rate, reducing the quite generous amounts now paid for small amounts.

The second reason not to require payment of lump sums relates to the fact that plans have unfunded liabilities. One of the great strengths of defined benefit plans is their ability to provide benefits for past service. When a plan is first established, benefits are credited for long years of past service before the plan was established, enabling the plan to provide adequate pensions for those already close to retirement. The cost of these past service benefits creates unfunded past service liability, required to be funded over a period of 30 years. If the plan is terminated before the past service liability is completely funded, certain benefits are guaranteed by the Pension Benefit Guarantee Corporation, while other unfunded benefits are forfeited. If a plan is forced to pay out lump sums for benefits not fully guaranteed, and if the plan subsequently terminates, PBGC will have a larger cost or other participants can lose some of their own non-guaranteed benefits.

The third reason for not paying lump sums is the sudden strain made on plan assets. This could force a plan to liquidate investments, perhaps at a loss. This need for more liquid assets might force plans to shift to more short-term investments, lowering the plan's investment return.

Since many plans have assets less than the value of all vested benefits, in some cases a requirement to pay vested benefits in a lump sum could cause the plan to become insolvent.

The purposes of portability is to preserve pensions otherwise dissipated as lump sums paid to participants, rather than to force plans to pay lump sums.

6. Alternative Funding Media for Portable Pension Fund Investments

Two types of funding media could be used for funding portable pension funds, either a federal portable pension fund or modified private sector IRAs. Either type can be designed with whatever features that Congress deems available. Either type could have its assets invested in private sector investments such as stocks and bonds, to the extent Congress decides that is appropriate. Each type has advantages and disadvantages, discussed later in this presentation.

7. Types of Investments for Portable Pension Funds

Many alternative underlying investments are available for use by either a federal portable pension fund or by IRAs. The following comments are so well known and obvious that I considered omitting them, but decided to include them because frequently the most obvious things are overlooked.

The objective of investing pension funds is to provide pensions. This means that one should seek to maximize the investment return while minimizing the risk of loss.

But the goals of maximizing return and minimizing loss require opposite strategies. Over most periods of the past common stocks have had higher returns than either bonds or short term investments such as treasury bills and money market funds.* Unfortunately common stocks are also very volatile. The average return on all common stocks was 37% in 1975, but was -26% the prior year.

---

* See Stocks, Bonds, Bills, and Inflation: 1984 Yearbook, Chicago: R.G. Ibbotson Associates, Inc.; 1984.

In contrast, short term investments such as money market funds and U.S. Treasury bills almost guarantee against any decline in market value, but in most periods have produced lower returns than common stocks.

Between these short term investments and common stocks lie bonds. In most periods of the past, the total investment return on long-term bonds has been higher than for short-term investments, but lower than for stocks. Corporate bonds have generally earned more than government bonds. Market values of bonds fluctuate, but the amount of fluctuation is generally much less than for stocks. If bonds are held to maturity, the risk of market value fluctuation is generally eliminated.

These various types of investments may be acquired directly, or the investor may participate in them indirectly through investment intermediaries such as mutual funds, insurance companies, banks and pooled trust funds. Both a federal portable pension fund and IRAs would involve a pooling of funds through one or more intermediaries.

IRAs would offer wide alternatives to choose from, unless Congress determined that certain kinds of alternatives should not be allowed because of the risk of loss. A federal portable pension fund could be set up as a single fund, presumably invested in bonds and other fixed dollar investments in order to avoid the risk of loss. Alternatively a federal portable pension fund could offer two or more alternatives, including both a fixed dollar fund for those who wish to avoid the risk of loss and a common stock fund for those who are willing to take risks in the pursuit of a higher return. However, I recommend against having a common stock fund within any federal portable pension fund, since the inevitable occasional declines in market value would not only result in losses, but also would be misunderstood and result in public dissatisfaction. In addition, if a governmental fund were to acquire substantial amounts of common stock with voting rights, this could create serious questions of the exercise of the voting rights under control of the portable pension fund, a problem avoided with bonds and other fixed dollar investments.

Therefore, I recommend that a federal portable pension fund be invested in long-term corporate bonds and other high-yielding fixed dollar investments such as guaranteed investment contracts (GICs). I recommend that all such investments be valued at amortized value, the method generally used by insurance companies, since such bonds can be help to maturity and the problems of market value fluctuation can thus be avoided.

An alternative to corporate bonds would be to invest the federal portable pension fund entirely in federal government bonds, as most governmental funds are invested. But such bonds have lower yields than high quality corporate bonds. If the portable pension fund were invested in the lower-yielding government bonds, this would not only deprive participants of part of their needed income, but would tend to discourage use of the fund at all.

It is in the interest of participants that a federal portable pension fund earn the highest rate of return consistent with prudent requirements for safety of principal and needs for liquidity. To this end the investments could be managed by banks, insurance companies and other institutional investors with proven ability to manage investment portfolios. Such investors are apt to be most successful if they are given the widest discretion within the basic "prudent person" rule. (See ERISA sec. 404(a)(1).)

Precedent for appointing investment managers to manage any pension fund for which the federal government has responsibility is seen in the investment of pension trust funds by the Pension Benefit Guaranty Corporation (PBGC). Similarly the federal government has long parcelled out its life insurance needs among dozens of insurance companies under the Federal Employees Group Life Insurance program. Because of its experience in selecting and supervising private investment managers for pension funds, PBCC might be given overall responsibility for investment of the fund.

8. Other Considerations in the Choice between a Federal Portable Pension Fund and IRAs

As indicated above, IRAs offer greater freedom to choose between investment alternatives, including freedom to invest in common stocks. This offers both greater chance of gain and greater risk of loss. Participants who are more cautious could choose an IRA invested in fixed dollar investments, such as money market funds, certificates of deposit and annuity contracts. Some argue that many workers are not well enough informed to make wise choices, but others argue that individuals should be free to make their own choices. The question is philosophical.

A federal portable pension fund could be run with lower administrative expense than most IRAs, and with no sales charge. This would probably produce a higher net return than those IRAs invested in fixed dollar investments.

In order to provide a life annuity at the time of retirement, any IRA not invested in an annuity contract would be transferred either to an annuity contract issued by an insurance company or to a federal portable pension fund. Because of the lower administrative expense and no sales expense, a federal portable pension fund should be able to provide more monthly income per $1000 of account balance. Social Security is administered at the remarkably low cost of less than 2% of deposits. No insurance company comes close.

IRAs would provide both debt capital and equity capital for the economy, while a federal fund would be concentrated in debt capital.

An individual who changes jobs frequently may receive many small rollover distributions. IRAs may not accept small amounts, or if accepted may necessarily have relatively high costs in administering them. If all of an individual's rollovers are directed to a central federal fund, the administrative costs can be minimized.

If an individual who changes jobs frequently has each employer send his rollover to a separate IRA, the administrator of the IRAs may have trouble locating the individual at retirement age, and the worker in turn may have trouble keeping track of all of his funds. On the other hand, if each worker is allowed to direct which IRA his distribution must be paid to, a large employer might be faced with the administrative burden of sending payments to many different IRAs, and still have the residual problem of undesignated amounts. A central federal portability fund avoids these problems.

9. A Combination of Approaches

I personally believe that a federal portable pension fund is the better alternative because it would protect participants from market value declines, and by combining all accounts in a single fund could minimize administrative expense and thus maximize the portion of the assets used to actually provide pensions.

However, a combination of the two approaches is possible, using both IRAs and a federal portable pension fund, with a federal clearinghouse to keep track of all of an individual's accounts.

All rollover distributions would be sent to the federal clearinghouse, which in turn would forward them to the bank, mutual fund or insurance company chosen by the participant. If no other vehicle were chosen by the participant, his deposits would be invested in the portable pension fund.

Because IRAs are generally held at market value, a participant could elect to transfer money between his IRA accounts or make transfers to the federal portable pension fund. If the federal portable pension fund is valued at amortized value in order to prevent market value fluctuations, as I recommend, it would not be feasible to allow transfers from the federal fund to IRAs, since this could lead to a rush to transfer out when bond interest rates rise and market values fall, resulting in realized losses for the fund.

When an individual's pension is to begin, the federal clearinghouse could direct all his IRAs to be transferred to the federal fund, where the total of his accounts would be applied to provide a life annuity.

10. Time of Benefit Commencement

Under the method of funding suggested in this report, an individual's account will continue to grow until benefits commence, at which time it will be converted into a monthly income payable for life. Each employee would receive a benefit for which the present value at retirement equals his account balance. The conversion factor would take account of the shorter life expectancy of older individuals, providing them more monthly income for each $1,000 of account balance than for younger individuals. The individual whose benefit begins at a later age would receive larger monthly payments than if he had retired earlier, but for a shorter period of years. Thus there is no inherent advantage or disadvantage in having payments start earlier or later.

Most workers continue to earn income until their Social Security benefits begin. At that time their earnings stop and the smaller Social Security benefits begin, so this is ordinarily the time when additional income is needed. Under Social Security a worker currently retiring can elect to have his full benefits begin at age 65 or reduced benefits begin at age 62. A disabled worker can have his Social Security benefits begin at any age. A worker not yet retired, because of the earnings test, does not ordinarily begin receiving benefits until age 70.

Administratively it would be simplest to have benefits under the portable pension fund begin at the same time as benefits under Social Security, which is ordinarily the time they are needed. Commencement at that time could be automatic unless the employee has elected earlier or later commencement.

What should be the minimum age to allow benefits under the portable pension fund to begin? Payments under IRA's may begin as early as age 59½, or at disability if earlier. Some pension plans allow retirement at age 55, and some even earlier, although benefits are usually reduced for retirement before age 65. A penalty tax applies to some pension payments before age 59½. Most pension plans experience few actual retirements before age 62, even if retirement is allowable at earlier ages, since few employees can afford to retire before age 62 when Social Security benefits begin. There is no clear-cut answer as to the minimum age when benefits should be allowed to begin. Age 59½ is suggested for consistency with IRA and pension plan rules. Restricting benefits to the time the individual is eligible for Social Security benefits (age 62 or disablement) would minimize the administrative problems of the portable pension system.

Should there be a maximum age to begin pensions from the portable pension fund? Benefits under IRA's, and for 5-percent owners under pension plans, must begin no later than the end of the taxable year the individual attains age 70½. It is recommended that payments be required to begin no later than age 70½.

11. Form of Annuity

There are many forms of annuity (e.g., life annuity with 60 payments guaranteed) payable under pension plans. Both to make the plan understandable by participants and to minimize administrative costs, a single form of annuity for all participants is recommended.

The maximum amount of monthly benefit can be paid if no benefits are payable after death. However, if the benefits are payable only during the participant's lifetime, some participants would die after receiving only one or a few monthly payments, forfeiting most of their account balance. One form of annuity found in insurance and annuity contracts is the cash refund annuity, under which a payment is made at death equal to the excess of the individual account at annuity commencement over the total of monthly benefits paid. This assures that the total payments will at least equal the account balance at retirement. The amount of monthly income that can be provided under a cash refund annuity for each $1000 of account balance is slightly less than could be provided if no benefits are payable at death.

Many participants have a spouse dependent on their income. Social security recognizes this by providing pensions for the surviving spouse of a deceased worker or retired worker. Congress decided that each pension plan must provide a qualified joint and survivor annuity as the basic form of pension for married participants. A qualified joint and survivor annuity under ERISA is usually a monthly amount payable for the lifetime of the participant, with 50% of that amount payable to the participant's spouse for life after the participant's death. The amount of monthly income that can be provided as a joint and survivor annuity for each $1000 of account balance is slightly less than could be provided as an annuity for only the lifetime of the retiree.

The joint and survivor annuity can also have a cash refund feature, so that if both the participant and the spouse die before receiving combined payments equal to the account balance at retirement date, the excess of the account balance will be payable as a death benefit to a beneficiary.

The amount of income that can be provided for participants depends upon the form of annuity, the ages of the retiree and the spouse, and the anticipated mortality and interest rates. At age 65, $10,000 can provide $102 of monthly retirement income for life (assuming 8% interest and the UP 1984 Mortality Table). The amount of monthly income that can be provided under by this $10,000 under the various forms of annuity described, assuming the retiree's spouse is also age 65, is as follows:

	Monthly Income Provided By $10,000
Life annuity for retiree, with no refund	$102
Life annuity for retiree, with cash refund	93
50% joint and survivor annuity, no refund	92
50% joint and survivor annuity, cash refund	92

About 70% of those reaching retirement age are married. Based upon the above assumptions, if all annuities for unmarried persons are paid as a life annuity with cash refund and if all annuities for married persons are provided as a 50% joint and survivor annuity, the monthly income that can be provided per $1000 is approximately the same for both. The same initial amount can be paid regardless of whether the individual is married or not, eliminating the need to make a determination of marital status at the time of retirement. Upon the death of the retired participant, the widow or widower can apply for the survivor's annuity, just as such individuals now apply for such benefits under social security, and a common determination of marital status can be used for both purposes.

12. Annuity factors

At each participant's annuity commencement date his account balance would be transferred to a combined retired participant's portion of the federal portable pension fund in order to provide his annuity payout. The system would work in a manner similar to that used by TIAA-CREF and by many insurance companies. Annuity factors are required to convert the account balance into an amount of monthly income. Such annuity factors are calculated based upon assumptions of mortality, interest and other factors. The administrator of the federal portable pension fund should be allowed discretion to adopt suitable factors upon the recommendation of the fund's actuary, and to revise the factors from time to time as conditions merit.

The annuity factors should not differ by sex. Thus monthly benefits for males and females for whom equal transfers were made to the fund would be equal. The use of joint and survivor cash refund annuities substantially reduces the differences in annuity cost by sex.

13. Cost-of-Living Adjustments

A fixed-dollar pension gradually decreases in purchasing power and is, in effect, a decreasing pension. It is highly desirable from the participant's viewpoint to have any pension paid contain automatic adjustments for cost-of-living increases. Social Security benefits are fully adjusted for cost-of-living increases. Most private pension plans lack automatic cost-of-living adjustments, because of their substantial cost. Private pension plans which do have automatic cost-of-living adjustments usually set a maximum on the amount of annual increase, for cost control purposes. Some plans without automatic adjustments make occasional ad hoc adjustments to help retirees meet the inflation problem.

Cost-of-living-adjusted pensions are substantially more expensive than fixed pensions, and the greater the increases in pension, the greater the increase in cost. To keep the portable pension plan financially sound, the initial amount of pension would need to be smaller for cost-of-living-adjusted pensions than if fixed pensions were provided. The amount of adjustment is illustrated below for persons retiring at age 65.

Annual Increase In Benefits	Approximate Initial Reduction Required
2%	14%
4%	25%
6%	35%

If the cost-of-living increases are unlimited, it is impossible to know how much of an initial reduction is required, so a maximum limit is required if the fund is to be self-supporting. This requires a compromise between the objectives of keeping pace with the cost-of-living and providing an initially adequate pension. A number of private employers have selected 4% as the point of compromise. A 4% adjustment would meet retiree needs during periods of moderate inflation. A disadvantage of providing such benefits is not only the lower initial return but the potential misunderstanding that the fund is providing low returns, when it is actually paying less in early years so that it can pay more later.

Another approach would be to provide fixed annuities, but apply any excess investment return over the assumed rate to provide post-retirement adjustments to the extent they are sufficient.

14. Death Benefits Before Retirement Income Begins

If a participant dies before his retirement income begins, his account balance could be paid to his beneficiary.

If the beneficiary is the participant's spouse, the beneficiary could be allowed the option of applying the account balance to provide a life annuity with cash refund.

15. Administration of the Portable Pension System

The agency administering a federal portable pension fund and/or acting as the clearinghouse for portable IRAs could keep track of the amount credited to each individual's portable pension account. The agency acting as administrator need not be the same as the agency acting as trustee and investment manager for the federal fund.

Any centralized portability program would have its own administrative costs, but it should be able to operate more efficiently, effectively, and economically than over a half-million individual pension plans acting separately. The Social Security Administration's total administrative costs for the Old Age, Survivors, and Disability Insurance (OASDI) programs are less than 2% of the benefit payments. Social Security already has the responsibility of notifying individuals of any deferred vested benefits under private pension plans to which they might be entitled, and has a vast and efficient administrative and recordkeeping system capable of receiving, storing, and retrieving information on millions of individuals by Social Security account number. It is the agency which most Americans already contact when they want their retirement income to begin, and would appear to be a logical agency to administer such a program.

16. Administrative Expenses

Administrative expenses may be divided into two parts: (1) those investment expenses directly related to investment of the fund and (2) general expenses. Investment expenses are clearly an appropriate reduction in investment income, so that participants in a federal portable pension fund could be credited with net investment income after deducting investment expense.

General expenses could also be deducted from investment income. Alternatively general expenses could be paid from general revenues of the federal government, just as most other governmental expenses of pension reform legislation have been.

In either event, because of higher start-up costs when the fund is small, the initial expenses might consume an unreasonably large part of investment income, discouraging use of the portable pension fund. Therefore Congress may wish to limit any expenses subtracted from the fund to 1% of fund assets, subsidizing the start-up expenses in the early stages.

17. Modification of ERISA Repayment Provisions

ERISA section 204(d) and Internal Revenue Code section 411(a)(7), which provide for the cash-out of lump sums, also state that if a partially vested employee receives a lump sum distribution of his vested pension and is later reemployed, the plan must provide full past service credit for the period for which he has already received a benefit unless (a) the plan allows him to repay his distribution (together with 5% interest in the case of a defined benefit plan) and (b) he fails to do so. Under such a provision, if the amount were transferred to the portable pension fund, the participant would not have the money available to transfer back. Some modification of this provision would be needed.

Another repayment provision is found in ERISA section 203(a)(3)(D) and Internal Revenue Code section 411(a)(3)(D). Under these sections a plan may provide that withdrawal by an employee of his own contributions will result in forfeiture of the employer-provided benefit, provided (a) the employee is less than 50% vested in the employer-provided benefit and (b) the plan allows the employee to repay his withdrawal with interest and have his employer-provided benefit reinstated. The problem is similar to the other withdrawal problem raised above.

18. Taxation

Taxation of portable pensions should be consistent with other taxation of pension plans. As with IRA rollovers, there would be no tax at the time a transfer is made to the portable pension fund. Payments to participants and beneficiaries would be taxed in the same manner as similar payments from a qualified plan of an employer.

19. Conclusion

The problems of a portable pension system have feasible solutions. Such a program, made available for voluntary use by private pension plans and combined with a limitation on paying lump sum distributions, would enhance the retirement security of millions of American workers.

E. Integration of Private Pension Plans with Social Security

1. The Concept of Integration

Private pensions and Social Security are closely interrelated. Private plans are designed to supplement Social Security. If the benefits or contributions of a plan are coordinated with those under social security, the plan is said to be "integrated".

An employer may have an objective of providing pension benefits which will enable long service employees to retire on a standard of living approaching that which they enjoyed prior to retirement. For example, an employer may want to provide benefits which, together with social security, will replace 70% of the employee's pre-retirement earnings. If the average employee receives a social security benefit of 42% of pay, the employer might also provide a pension of 28% of pay, making a total pension of 70% of pay. But social security provides far less than 42% of pay for employees earning more than the taxable wage base. The social security benefit for an employee earning $50,000 per year is only about 17% of pay. Thus if the employer provided all employees a pension of 28%, the employee earning $50,000 per year would have a total income from both sources of only 45% of pay, far less than the 70% objective.

The employer's cost should also be considered. In 1985 employers pay social security tax of 5.70% (excluding the 1.35% for hospital insurance) of the first $39,600 of earnings, and 0% of any excess. If an employer wants to spend an equal percentage of pay for each employee for his combined social security and private pension, it can afford to spend more for private pensions related to pay in excess of the taxable wage base.

The above discussion assumes that the employer's objective is to provide a benefit program to meet the needs of employees, which also furthers employer objectives of attracting and retaining employees. But many smaller businesses establish pension plans primarily for the purpose of deferring taxation for the owner or owners and other key employees, while desiring to minimize plan benefits and costs for lower-paid employees. These employers use integration as a tool to help accomplish this end, providing little or no benefit at all for lower-paid workers.

There are three general methods to integrate private pension plans with social security. First, the amount of contribution to a defined contribution plan can be integrated with the social security tax. For example, the employer might contribute 10% of total pay less the amount of social security tax paid, e.g. in 1985 the employer would contribute 4.3% (10% less 5.7) of the first $39,600 of pay and 10% of any excess.

The second method of integration, used for defined benefit plans, is to first calculate the pension under the plan's benefit formula and then reduce or "offset" this amount by some percentage of the benefits payable under social security. For example, an offset plan might provide pensions of 50% of pay less 50% of the primary insurance amount payable under social security.

The third method of integration is the "excess" plan. A pure excess plan provides pensions based on pay above a certain level, usually the level upon which social security benefits are considered to be based. IRS tables, recognizing that Social Security benefits are based on average earnings including years when the taxable wage base was much lower than today, assume that employer taxes provide Social Security benefits equal to 37.5% of the first $13,800 of pay for those retiring at age 65 in 1985. Using this assumption, a private pension plan may provide 37.5% of the pay in excess of $13,800. More common than the pure excess plan is the "step-rate" plan, which provides one rate of pensions based on pay up to the integration level and a higher rate of pensions based on pay over the integration level. For example, the plan might provide pensions of 40% of the first $13,800 of earnings plus 77.5% of earnings in excess of $13,800.

2. Integration and the Internal Revenue Code

The Internal Revenue Code provides that contributions or benefits provided under a plan may not discriminate in favor of employees who are officers, shareholders, or highly compensated. A plan may pay larger pensions (measured in dollars) for highly compensated employees than for others, but it may not provide a larger percentage of pay for highly compensated employees than for others. A plan is not considered discriminatory merely because it excludes employees earning less than the social security taxable wage base, or merely because the contributions or benefits based upon earnings in excess of the taxable wage base differ from contributions or benefits based on earnings not exceeding the taxable wage base.

Thus the Code permits integration of contributions or benefits with Social Security. But the combination of benefits under the employer's plan plus the portion of Social Security benefits funded by employer taxes may not discriminate in favor of the highly paid. The IRS has published very extensive and complex rules to determine when this general concept is satisfied.* When I was Director of the Actuarial Division of the Internal Revenue Service, I was responsible for administering these rules in the national office.

3. Problems with the Present Integration Requirements

The IRS rules have four major problems. They are outdated, unfair, and far too complex, and they fail to meet the needs of lower income workers.

The rules are outdated. They fail to recognize changes in social security benefit levels that have occurred since 1971. If no other changes are made, updating the rules to reflect current law is in order.

*Rev. Ruls. 71-446, 72-276, 72-492, 75-480, 78-92, 83-53, 83-97, 84-45. For an explanation of the rules see "Integration of Plans with Social Security", by D.S. Grubbs, Series C, Folio 5, Pension and Profit Sharing Plans, American Law Institute-American Bar Association, Philadelphia, (1979).

The rules are unfair. They allow an employee hired at age 64 and retiring a year later at age 65 to have the small pension earned for his one year of service offset by 83-1/3% of the social security benefit earned over his entire working career, even though most of the benefit was earned with prior employers.

The complexity of the rules is a serious problem. Many attorneys who work with pension plans don't understand them. Frequently IRS personnel in District offices fail to understand them, approving plans that do satisfy the rules and rejecting plans that do satisfy them. Some think that this complexity is needed in order to precisely reflect the amount of employer-derived social security benefit under a wide range of situations, but in fact the rules do not even come close to doing so today, if they ever did. Thus the complexity does not actually accomplish the goal of equity, and no one either inside or outside of government is advocating modifications that would do so. Experience shows that we can get along with some imprecision.

The rules fails to meet the needs of lower income workers. The rules are intended to assure that the combined benefits under social security and the private pension plan do not discriminate in favor of higher paid employees. But the rules do not attempt to assure suitable benefits for lower paid employees, and indeed they fail to do so. For example, they allow a plan to provide a pension of 1% of pay up to $13,000 and 38.5% of pay over $13,000; this may be non-discriminatory when considered in combination with social security, but it does not provide adequate pensions for lower paid workers.

4. Disruption and Cost of Change

Hundreds of thousands of plans are integrated with social security. To require all of these plans to be amended would have substantial cost. The costs include the fees paid for studies and additional actuarial computations, the time spent by the employers' management, the cost of preparing amendments and submitting them to the IRS for approval, the cost to IRS of reviewing all of the requests for approval, the cost of communicating the change to participants and the cost of reprograming the computer production of annual individual benefit statements which calculate each individual's accrued pension. Thus changes should not be required where not clearly needed.

While some integrated plans are clearly unfair and fail to meet the needs of lower paid workers, the majority of participants in integrated plans are under plans that have no such problems. For example, most plans have a benefit formula based upon years of service and average pay over the last 5 years. A common benefit formula provides a benefit equal to 0.75% of average pay not exceeding $13,800 plus 1.50% of an average pay exceeding $13,800. For typical employees retiring at age 65 today after 40 years of service, this formula produces the following benefits:

Five-Year Average Pay	Final Pay	Annual Pension			Total Pension As a Percent of Final Pay
		Pension Plan	Social Security*	Total	
$ 6,900	$ 7,774	$ 2,070	$ 3,732	$ 5,802	75%
13,800	15,548	4,140	5,640	9,780	63
20,000	22,534	7,860	7,332	15,192	67
50,000	56,335	25,860	8,604	34,464	61
100,000	112,670	55,860	8,604	64,464	57

*Assuming annual pay increases in past years equal to indexed earnings plus 1%, based on computations by Harvey Kesselman.

While not perfect, such a plan has relatively little discrimination and does a reasonably good job of meeting retirement income needs at all levels of pay. Such a plan should not be required to be amended by any new rules.

5. Criteria for Revised Integration Requirements

(1) Substantial discrimination should be prohibited.

(2) Minimum benefits for lower income workers should be required.

(3) The level of minimum benefits should be related to the level of integration, both in fairness and to give the owners of small businesses incentives to give more to lower-paid workers in order to get more for themselves.

(4) Outdated concepts, such as basing the integration level on the social security "average monthly wage" which is no longer used to calculate social security benefits, should be discarded.

(5) The rules should be simple. Unlike present rules, the allowable amount of integration should not be adjusted for the form of annuity, pre-retirement death benefits, disability benefits, employee contributions or retirement age. Most of all, we should avoid merely adding an additional requirement to the already overly complex rules for defined benefit plans.

(6) Most plans which do a reasonable job of meeting these requirements should not be required to be amended.

6. Proposed Solution for Defined Contribution Plans

Defined contribution plans can currently provide contributions of 0% of the first $39,600 of pay and 5.70% of the excess. This properly reflects the social security tax and prevents discrimination, but does not assure that lower paid workers will receive any contributions. The rule should be supplemented with a second requirement. The percentage of contributions below the breakpoint should equal at least half of the percentage of contributions above the breakpoint.

7. Proposed Solution for Offset Plans

For defined benefit offset plans, the present complex rules should be replaced by three simple requirements. First, the percentage of the primary social security benefit that is offset should not exceed the percentage of average pay (over a period of at least three years) used to calculate the benefit being offset. Second, the benefit before offset should not exceed 100% of the 3-year-average pay. For example, a plan could provide 50% of average pay offset by 50% of the social security benefit or 100% of pay less 100% of social security, or 1% of pay less 1% of social security, multiplied by years of service. It would not permit those present offset plans which now provide little or no benefit at all for lower paid workers. Third, adjustment is required for early retirement.

8. Proposed Solution to Excess Plans and Step-Rate Plans

Pure excess plans provide no benefit whatsoever for lower paid employees, and should not be allowed.

Step-rate plans credit a higher percentage of benefit based on pay above the breakpoint than pay below the breakpoint. The present complex rules for step-rate plans should be replaced by four simple requirements.

First, the pay upon which benefits are based should either be each year's pay or the average pay over at least three consecutive years.

Second, the breakpoint should not exceed the social security taxable wage base for the year prior to termination of employment. For example, for participants terminating in 1985 the integration breakpoint could not exceed 1984's taxable wage base of $37,800. An argument could be made for instead using the maximum average indexed monthly earnings (AIME) upon which social security benefits are calculated, but few people know what AIME is or how to calculate it, and the Social Security Administration has estimated that in the long run the annualized AIME would equal about 92% of the prior year's taxable wage base.

Third, the percentage of benefits above the breakpoint should not exceed 100%. Replacement of more than 100% of pay would be excessive.

Fourth, the percentage of pay below the breakpoint should be at least half the percentage of benefits above the breakpoint.

Like the present rules, the amount of integration under the proposed rule for step-rate plans differs somewhat from that under the proposed rule for offset plans. But in the aggregate the proposed rules for the two types of plans are roughly comparable.

9. Coordination with Social Security Retirement Age

Both the amount of benefits and the retirement age under social security are directly or indirectly reflected in the design of private pensions plans.

ERISA and the Internal Revenue Code require that the normal retirement age of private pensions not exceed the latter of age 65 or 10 years of participation. This age 65 maximum, which is the normal retirement age under most private plans, was geared to mesh with social security. But in 1983 Congress changed the retirement age for unreduced benefits under social security, gradually increasing it from 65 to 67.

It makes sense to have benefits begin at the same time under both social security and private pension plans. Therefore ERISA and the Code should be amended to allow private pension plans to use the same normal retirement age as the age for unreduced benefits under social security.

The anti-cutback rules in present law would prevent any change from reducing any benefit already accrued.

10. Conclusion

As indicated earlier, the present rules are outdated, unfair and far too complex, and they fail to meet the needs of lower income workers. Replacing the present complex maze with the simple proposals described would solve these problems, and would satisfy the criteria described for a solution.

F. Limitations on Benefits and Contributions

Section 415 of the Internal Revenue Code sets maximum limits on the benefits and contributions for individuals under qualified plans. There are two type of limits, percentages of pay and dollar amounts.

The complexity of these requirements is a severe problem. Most plan administrators are not able to understand the rules. There will be extensive violations of the requirements, not because of deliberate intent but because of the inability to understand and administer them.

A second problem with the requirements deals solely with the dollar limits. While these dollar limits were intended to restrict benefits only for the highly paid, they indirectly impact all employees. Because of the dollar limits, establishing a generous percentage benefit formula does not benefit key employees, so a lower percentage benefit formula is often adopted for all employees. The dollar limit takes away the carrot needed to encourage smaller employers to establish more liberal benefits for all employees.

My proposed changes in the integration requirements, coupled with the existing nondiscrimination requirements, would assure that the owner of a small business can get generous benefits for himself only if he provides generous benefits for other employees. Adopting new integration rules would make it desirable to delete the dollar limits of section 415. These dollar limits restrict the owner's benefits and diminish his incentive to provide generous benefits for others.

Deleting the dollar limits in section 415 would also greatly simplify the complexity referred to above.

G. Top-Heavy Requirements

Section 416 of the Code, added in 1982, established minimum requirements for "top-heavy" plans. In general terms, a top-heavy plan is a plan under which most plan assets are used to provide benefits for "key employees" (officers and shareholders). The intent is to assure that non-key employees will receive a fair share of plan benefits.

Top-heavy plans are required to provide more rapid vesting, to provide minimum benefits for non-key employees, and to restrict the compensation used to calculate contributions and benefits for highly paid employees.

Calculations necessary to determine whether a plan is top-heavy, coupled with the requirements which apply if a plan is top-heavy, create administrative burdens and expense for plans.

Requiring all plans to provide full vesting after 3 years of service, as is recommended, would provide vesting as rapid as that required for top-heavy plans under section 416. Thus there would be no further need for the vesting requirements of section 416.

Adopting the fairer integration requirements I have recommended, coupled with the existing general nondiscrimination requirements, would assure that all employees receive fair benefits. This would eliminate any need for minimum benefit requirements and the maximum compensation limit.

Thus if Congress adopts more rapid vesting requirements and fairer integration requirements for all plans, it should delete section 416 entirely. This deletion would reduce the administrative burdens and expense for plan sponsors.

H. Summary of Recommendations

The following measures are recommended:

1. Prevent any reduction in social security cost-of-living adjustments.
2. Require full vesting after three years of service for all plans.
3. Forbid lump sum distributions from plans, with certain appropriate exceptions.

4. Establish a portable pension system, composed of modified IRAs, a federal portable pension fund, and a federal portable pension clearinghouse.
5. Revise requirements for integration of private pension plans with social security to make them fairer, simpler, and current, and to meet the needs of lower income workers.

These changes will assure that American workers accrue pension benefits more fairly, that more of the accrued benefits will be preserved, and that the administrative burden and administrative expense for plan sponsors will be reduced.

Mr. CLAY. Thank you.

Mr. Carter.

Mr. CARTER. Thank you.

Mr. Chairman and members of the subcommittee, I, too, would like to congratulate the committee on holding these hearings concerned with a national retirement policy. I assume I am primarily here because of my membership on the President's Commission on Pension Policies.

I want to talk briefly about one aspect of that report which is called "Toward a National Retirement Income Policy," and which recommended that we needed to take a broad approach to dealing with the retirement problems of American workers.

The President's Commission found that the most serious problem facing our retirement system today is the lack of pension coverage among private sector workers. That situation which was found in 1981 has not improved significantly today.

Roughly half of American workers are covered in some way under a pension plan. Even if we eliminate self-employed, agriculture, and part-time workers, those over 65 and under 25, or those on the job less than 1 year, the 16 million workers or 30 percent of those who would normally be expected to be covered under the ERISA standard are not covered.

If we add back in those workers who meet other ERISA characteristics but have been employed less than a year and the reduction from 25 to 21 under the Pension Equity Act, then it is clear that that 30 percent is significantly higher.

So, I would like to endorse Mrs. Roukema's concern for this population as being one that would commend itself to the primary attention of this committee in considering a national pension policy.

As for the future, we can't see much prospect under the present circumstances for improvement, and that is because most of the noncoverage is in the areas of highest growth. For example, in the service area, some 35 percent of workers are covered, and in the retail trade it shrinks to 28 percent of workers.

If one looks at the problem by income level, then among the noncovered, 90 percent are persons earning $25,000 or less, and they are found mainly in firms of 100 employees or less, and this is the area of most concentration as far as failure to provide a pension plan.

So, in sum, the problem of noncoverage is in the low or moderately paid workers and nonunion small firms and the growing service and retail sectors, and these are the firms where we are likely to find the largest concentration of women and minorities.

When we consider the alternate effort, particularly the IRA provisions of ERISA that were intended to provide an incentive for people who did not have coverage to provide coverage for themselves, we find that in 1978 only 6 percent of persons between $10,000 and $25,000 of income had IRA's, and even after the expansion of the IRA Program and the great publicity around the program, that percentage increased only to 13 percent of all workers.

On the other hand, if you look at those above $50,000 of income, in 1978, 29 percent had IRA's and in 1982, 45 percent. So, whatever the intent of this program, it has patently not met its purposes. It is really perverse public policy because, on the one hand, it puts the burden on those with the least disposable income to provide for their own retirement, and on the other it rewards those most, through the tax system, who are most likely to have employer contributions and also other savings in other instruments.

In this connection, it should be noted, however, that participation in IRA's does go up if it is offered on a payroll deduction plan through the employer, but a broader program, a more attractive program such as 401(k), as Mr. Monks referred to, is much more highly utilized than the IRA Program.

I would suggest, Mr. Chairman, that these findings do give us some clues as to what might be done in connection with providing more coverage to workers at the lower level. I note in passing that the Commission recommended a mandatory minimum universal system, and it recommended this because it felt that this was the only way that it was going to be able to assure that these workers would have this important second leg of the three-legged stool, or the triad, or whatever one would call it.

It is unlikely, of course, that in the present climate we are going to have a mandatory program. Nevertheless, it does seem important for the committee to recognize in any legislation the need for minimum retirement income and the need for the three aspects of minimum retirement, that is, Social Security, a private pension plan, and other savings, and to declare as a national policy the goal of achieving the universal coverage necessary to carry out that second point, recognizing that Social Security by itself, except for perhaps some workers below $10,000 in income, cannot provide a sufficient answer.

Moreover, recognizing the failure of IRA's in their present form, there should be a shift in the way these incentives are provided toward the lower and moderate income, and this could be accomplished in part by limiting the IRA tax deductibility to the minimum tax rate, and allowing targeted workers a limited tax credit option refundable against Social Security taxes to the extent the credit exceeds income taxes owed.

I would also urge the adoption of the tax incentives proposed by the President's Commission which would do the reverse. They would raise to the highest rate for small employers with lower incomes the highest tax rate applicable to corporations for their contributions both to retirement pay and also administrative contributions.

If, indeed, we move toward some form of portability system in the fund, then this would enable these employers significantly to reduce their administrative costs by using that fund for the implementation of the programs in small firms and at the same time attain for their employees significant benefits available to larger funds.

In the meantime, the Labor Department and the Social Security Administration should be required to promote the use of employer simplified employment pension programs and encourage voluntary employee retirement savings and there should be a constant monitoring on coverage, with the Congress reviewing this periodically, and where necessary introducing further mandatory provisions such as, perhaps, making the availabililty of SEPs mandatory.

I know that it will be said by some that this flies in the face of the current efforts toward dealing with the deficit and tax simplification, but to the extent that the tax system is going to be used to assure pension retirement funds for American workers, then it is unjust not to have that system applied in a way which assures benefits to those who are low and moderate.

[Prepared statement of Lisle C. Carter, Jr., follows:]

Prepared Statement of Lisle C. Carter, Jr., Verner, Liipfert, Bernhard, McPherson & Hand, Former Member, President's Commission on Pension Policy

Mr. Chairman and Members of the Subcommittee,

I congratulate the Subcommittee on holding hearings addressed to the need for national pension policy to assure adequacy of retirement benefits. ERISA was a vital piece of legislation to protect private pension plans and assure fair treatment, but it did relatively little with respect to adequacy. Since ERISA there has been piecemeal legislation but no comprehensive approach. In 1981, the President's Commission on Pension Policy called for such an approach as essential to meeting the retirement needs of the American people.

I want this morning to discuss briefly with the committee one aspect of such a comprehensive approach that the President's Commission thought central to any national policy and concerning which it made its most controversial proposal, that is adequacy to coverage. The overwhelming majority of this commission of centrist to conservative men and women recommended a minimum mandatory pivate pension plan, not because they were enthusiastic about such an initiative, but because they were so alarmed about the need that the mandatory proposal sought to meet. Nothing that has happened since 1981 has reduced the cause for alarm. If the Congress does not favor a mandatory approach, it nevertheless has a responsibility to face the reality of little or no retirement coverage for millions of American workers who after working all their adult lives will enter retirement with the prospect of turning to public welfare to provide a minimum income.

The President's Commission found that "the most serious problem facing our retirement system today is the lack of pension coverage among private sector workers." It also predicted that coverage would not increase significantly under current circumstances.

Data recently compiled by Emily Andrews of EBRI show that almost 48% of, or 47 million, workers lacked coverage in 1983. Even if the self employed, agricultural and parttime workers and those over 65, under 25, or on their job less than 1 year were eliminated from this count, the 16 million workers or 30% of those who might be expected to be covered by ERISA in fact were covered by no pension plan. This number does not include those whose only difference from covered workers is that they have been on the job less than one year. Moreover, it does not include those between 21 and 25 who are now to be covered under the Pension Equity Act of 1984. If these two groups were included, it is plain that the proportion of ERISA characteristic workforce uncovered would be substantially higher.

A closer look at coverage by employment sector, according to Department of Labor data, gives little reason to believe that the proportion of private pension plan coverage is going to increase without new initiatives. The highest coverage, as would be expected, is among union workers, in 1983 some 77%, but union employees are a diminishing share of the private work force. The highest sector coverage is in manufacturing where employment growth is likely to be moderate. In the fast growing service sector only 35% of workers were covered; in retail trade only 28%. These sectors mirror the small nonunionized firms. It is worth noting that in all sectors, coverage of women lagged significantly behind coverage of men.

Finally, examination of the data by income level shows that noncoverage is highest at low to moderate income levels. Over 54 percent of all workers without coverage earn between $10,000 and $25,000 a year. 35% of such workers earn less than $10,000. In other words 90% of noncovered workers earn less than $25,000. A substantial proportion of these workers are employed in small firms.

More detailed analyses of these substantial coverage variations do not blunt their main thrust. Low to moderately paid workers in nonunion small firms in the growing service and retail sectors are largely without private retirement coverage. Because of the concentrations of women and minorities in employment with these characteristics, the consequences of the lack of coverage is likely to fall most heavily on these groups.

Alternate efforts to provide alternate retirement benefits for noncovered workers have not been successful. ERISA adopted the Individual Retirement Account (IRA) as a vehicle to encourage retirement savings among workers who were without employer provided benefits. In 1978, of some 12 million eligible workers earning between $10,000 and $25,000 6% had invested in an IRA. In 1982, after the expansion to cover all workers and the first year of extensive advertising and promotion, only 13% of workers not covered by private pension plans at those earings levels had invested in IRAs. On the other hand, IRA investment was heaviest among the best compensated. Over 29% of employees with salaries over $50,000 in 1978, and over 45% in 1982, put savings into IRAs. These outcomes are hardly surprising. IRAs as an answer to noncoverage are perverse public policy. On the one hand, they put the burden on those with the least disposable income to provide for their own retirement; on the other hand, they reward most through the tax system those who are both likely to have employer contributions to their retirement and to have substantial disposable income, and thus savings in other instruments.

An important related finding of the Andrews study is that participation in employer sponsored employee contribution programs is greater than in programs that rely wholly on voluntary initiative. This is markedly true for the increasingly popular 401(k) plans but it is also true for payroll deduction IRAs at the $10 - 25,000 wage levels. 401(k) plans, of course, are not basically retirement programs and are largely concentrated in higher salary firms. Nevertheless, that finding can have important implications for policies that seek to address the coverage issues.

LESSONS FOR A NATIONAL POLICY

It is clear that the coverage problem is serious and substantial and thus not to be ignored in any policy that purports to assure adequacy of retirement benefits. Even if those with incomes under $10,000 are considered to be largely provided for by Social Security, this certainly cannot be said of the 54% of noncovered workers with incomes between $10,000 and $25,000. These workers are heavily represented, 80% in 1979, in firms with less than 100 employees and in the rapidly expanding service and retail trade sectors. The cumulative evidence demonstrates that their needs will not be met through individual voluntary retirement savings even when encouraged by tax deductible contributions, and suggests that effective programs must be linked to the work place.

According to the President's Commission report, experts cite as primary reasons for lack of private plans in small firms contribution and administrative costs against low profit margins and fierce competition, less favorable income tax benefits because of lower taxable incomes and the large turnover of small business startups and failures. Its Minimum Universal Pension System was designed to address both the employees' needs and the realities of the small firm economic environment. Whatever programs are formulated to expand coverage among employees in the ERISA characteristic work force will have to deal with these considerations. It may well be that development of an effective policy for expansion of pension plans would be best advanced if we had better information directly from small firm employers as to why they do not have pension plans, but it would be most unfortunate to adopt new national retirement policy legislation that failed to deal with the coverage gap.

There are three basic approaches to meeting the coverage need: (1) a second tier to Social Security which would be a privately invested mandatory employer program; (2) a wholly private program such as proposed by the President's Commission; (3) a voluntary program designed on the experience or realities of low to moderate income earners in small firms. These might of course be combined in some fashion.

Mandatory programs have the obvious advantage that they would assure the provison of retirement benefits in addition to Social Security. For workers with little disposable income such programs may prove in the end the only way to assure retirement savings. Here retirement savings must clearly be distinguished from other savings programs such as those under 401(k). The flexibility of purpose and accessibility of savings may make 401(k) programs attractive to many employees. But those very factors mean that 401(k)s are not a satisfactory vehicle for public policy concerned with adequacy of retirement income for those who have no retirement programs. Mandatory programs may prove, moreover, to be the only way to deal with the cost disincentives and competitive pressures in small firms.

Nevertheless not only does the present political climate undoubtedly not favor such programs, but it probably can be maintained that we have not yet tried a carefully targeted and designed, vigorously promoted voluntary program. There has certainly been no legislation which has attempted to deal with the realities of workers without coverage. Elements of such a program might include the following:

a. Adopting as a goal the assurance of a minimum retirement income and the recognition of a need for retirement benefits beyond Social Security to accomplish that end.

b. Establishment, as essential to accomplish this goal, of the additional goal of universal retirement benefit coverage and the requirement that private employee retirement plans move toward such coverage over time.

c. Tax incentives targeted for the moderate to lower income who are not covered by pension plans. The perverse IRAs should be reduced and the tax benefit shifted toward the greatest need. This might be accomplished by limiting IRA tax deductibility to the minimum tax rate and allowing targeted workers a limited tax credit option refundable against Social Security taxes to the extent the credit exceeds income taxes owed.

d. Adoption of the tax incentives proposed by the President's Commission to increase tax contribution and cost deductions to highest rates for small firm employers who establish pension plans.

e. Requirement that the Labor Department and Social Security Administration promote use of employers simplified employee pension programs to encourage voluntary employee retirement savings.

f. Requirement that the Labor Department monitor coverage of workers and periodically survey employers; together with congressional reviews of findings to determine what additional legislation might be needed. For example, after a time it may appear desirable to make the SEP program mandatory.

I recognize that the combination of deficit reduction and tax simplification are raised today as the objection to every proposal to use of the tax system to meet social needs. But the system is already massively and quite properly involved as the major incentive to encourage provision of retirement benefits for American workers and their families. Indeed, the Treasury in its simplication proposal not only excluded employer retirement benefit contributions from among those employee benefits it would make taxable, but even proposed further expansion of IRAs. The proposals I have made are addressed to meeting the gravest inequity in the private system, that is the total failure of provision for millions of workers. This is a failure which if it persists calls into question the justifiability of the entire system. For at present the private system represents a tax subsidy from those who can least afford it to the better off. Worse, it offers men and women who have worked throughout their lives the prospect of an old age of anxiety and poverty.

In closing, I want to thank the committee for giving me this opportunity to appear and make a statement on this most important issue.

Mr. Clay. Thank you.

Mr. Carter, when the Commission made its recommendation about a minimum universal pension plan, did they also give any estimation as to what it would cost the Treasury in terms of the tax writeoffs and incentives?

Mr. **Carter**. Yes, it did, Mr. Chairman, and I don't have that number with me today.

Mr. **Clay**. Will you supply it for the subcommittee?

Mr. **Carter**. Yes.

[The information to be furnished follows:]

Law Offices,
Verner, Liipfert, Bernhard, McPherson & Hand
Washington, DC, April 24, 1985.

Hon. William L. Clay,
Chairman, Subcommittee on Labor-Management Relations, Committee on Education and Labor, House of Representatives, 2451 Rayburn House Office Building, Washington, DC.

Attention: Ms. Phyllis Borzi.

Dear Mr. Chairman: During my testimony before your subcommittee on April 2nd, you asked for the costs of the proposal by the President's Commission on Pension Policy for a minimum universal pension system (MUPS). The intent of the proposal was to assure a minimum coverage for all workers who were 25 years old, one year of service and at least 1,000 hours of work per year. The earnings contribution by the employer would be 3 percent of annual earnings. The plan would provide full and immediate vesting.Attached is a copy of a table from the Commission's Report which shows the estimated cost to private sector employers. The table assumed a phase-in of over 3 years, reaching the full 3 percent in the third year. The extension of ERISA's provisions to workers 21 years of age, in addition to normal price increase adjustments, would probably change these numbers significantly.

I hope this information is useful in your subcommittee's deliberations. If I can be of any further help, please do not hesitate to let me know.

Sincerely,

Enclosure.

TABLE 23.—ESTIMATED COSTS FOR PRIVATE SECTOR EMPLOYERS OF COMMISSION'S MINIMUM UNIVERSAL PENSION SYSTEM (MUPS) PROPOSAL

[Dollars in billions] [1]

Year MUPS contribution requirements by size of establishment	Current policy costs	Added costs	Business tax savings [2]	Net cost increase
(Expressed in 1982 dollars):				
Less than 100 employees	$21.1	$3.2	$2.5	$0.7
100 to 500 employees	13.4	1.1	.7	.4
500 or more employees	22.3	1.0	.5	.5
Self-employed workers	2.1	1.0	.7	.3
Total	58.9	6.3	4.4	1.9
(Expressed in 1983 dollars):				
Less than 100 employees	23.0	6.3	4.1	2.2
100 to 500 employees	14.6	2.0	1.2	.8
500 or more employees	24.3	1.7	.8	.9
Self-employed workers	2.3	2.2	1.3	.9
Total	64.1	12.2	7.4	4.8
(Expressed in 1984 dollars):				
Less than 100 employees	24.7	9.5	5.7	3.8
100 to 500 employees	15.7	2.9	1.7	1.2
500 or more employees	26.2	2.6	1.2	1.4
Self-employed workers	2.5	3.6	1.9	1.7
Total	69.1	18.6	10.5	8.1

[1] All private and public employers must offer a retirement plan with participation standards no stricter than age 25, one year of service, and 1,000 hours of work annually and full and immediately vesting. These estimates assume a phase-in of MUPS requiring a one percent of earings contribution by employers in 1982, a two percent contribution in 1985 and a three percent contribution in 1984. The Commission's Special MUPS Business Tax Credit is assumed to apply to the first 3% of payroll contributions to qualified pension plans.

[2] These tax savings estimates have two components. Employees earnings below $100,000 who currently contribute to a qualified pension plan are assumed to receive the special MUPS Business Tax Credit for the first 3 percent of payroll contribution. All new contributions by employers due to MUPS are subject to the higher of the tax credit or normal tax deduction.

Source: ICF, Inc., estimates for President's Commission Pension Policy; Estimates by President's Commission on Pension Policy.

Mr. **Clay**. Mr. Grubbs, the Treasury Department says that since only 50 percent of the American public is covered by retirement plans, that it is unfair to the other 50 percent to impose on them the obligation of buying this kind of a benefit after taxes.

At our March 21 hearing, Lane Kirkland said that slashing the tax incentives for employee benefits will not improve tax equity. What is your opinion on that?

Mr. GRUBBS. I think one has to look at the various types of retirement benefits and employee benefits separately, but by and large I believe we need these tax incentives, that the primary goal was to meet the needs of workers, and without those incentives those needs just aren't going to be met.

Mr. CLAY. Mr. Monks, when you talk about defined benefit plans and defined contribution plans and you say there should be a balance between the two, I think you made that statement, can you elaborate on that for us?

Mr. MONKS. Yes, Mr. Chairman. It seems to me that there is a role for both. As hard as I have tried, I can't feel a sense of confidence that either a system which is, as I pejoratively call it, paternalistic, that takes care of people, is the total answer; nor is a system in which the entire risk of failure of investment in itself a satisfactory explanation.

So it seems to me that an enlightened retirement policy would be one that included percentages of both and I think if such a view recommended itself to yourselves, you might think of ranges of percentages, such and such a percent would be a defined benefit; such and such a percent could be a defined contribution.

That is what I had in mind, Mr. Chairman.

Mr. CLAY. Thank you. Mrs. Roukema?

Mrs. ROUKEMA. There are a lot of questions that you have opened up in your testimony. It was very thoughtful and provocative.

Let me begin with a general question. The President's Commission on Pension Policy and the statements of a number of you who have testified today all, of course, want to broaden the coverage. Could each of you comment on what you see as a specific barrier under ERISA to that expansion?

You have all spoken to it in one form or another, but if you had to tell us how we should target our effort to erase the barriers that you presently see, what would you recommend? Maybe we could start in the order in which you testified. Mr. Ross?

Mr. ROSS. Yes, I think there are two things you can do, one substantive, one procedural.

Procedurally, I think the present system of administration, with this fragmented regulation in Labor, IRS, and other agencies, makes it extremely onerous and difficult and also produces a lot of unintelligent regulation. I think the reasons for this were jurisdictional turf battles. They have nothing to do with sound public policy.

Doing something to bring some rationality and consistency to the administration of this area would be important as a procedural matter to giving it a new lease on life.

Second, from a substantive standpoint, I think we ought to go back into the tax laws particularly, and realizing that you can't do everything, but realizing that we are subsidizing this area through the tax system, do a better job of establishing our priorities and putting our tax expenditures where they belong to achieve the goals we want instead of having them spread broadly through a variety of programs, some of which are quite marginal to our national goals.

Mrs. ROUKEMA. And that doesn't include tax simplification.

Mr. ROSS. It would include tax simplification. I think right now we have had a proliferation of programs in the employee benefit field where we spread our tax expenditures all over. I think we ought to force the tax expenditures to be made on things which achieve things that are in the greatest interest to the greatest number of workers.

I don't think that is happening now. There is a lot of waste in the tax expenditure area. With sufficient time, I could go through details and tell you how I would prioritize what we are doing there.

Then third, if you do something procedurally, you do something to make the tax expenditures more rational, then I think you come around to things that are closer to home to this committee and you do some regulation and you provide for some social goals that you want to achieve from a broader standpoint that permeate the area you provide real leadership and guidance as to where we are going in this area.

So that would be my program.

Mrs. ROUKEMA. Thank you. Mr. Monks?

Mr. MONKS. Mrs. Roukema, I would like to focus on just one facet of the three-legged stool that you mentioned earlier, which is savings. I think to take a leaf out of what Stan was suggesting, retirement income is being charged with a whole variety of expenses in the popular imagination, not all of which are really fairly allocable to retirement income questions.

On savings I am reminded of the so-called Gresham's law which, as you know, says bad money drives out good, and I think in the retirement income area, tax-aided savings are threatening to drive out nontax aided savings. So we are in a sense creating two worlds. We are creating a world in which there are marvelously attractive programs in which tax deduction is given for what are essentially savings plans.

I think in your testimony you referred to the fact that these were about 50 percent of the people.

Mrs. ROUKEMA. Mr. Monks, will you speak into the microphone? I am afraid those in the back cannot hear your testimony.

Mr. MONKS. I am sorry. I hope they still want to.

Mrs. ROUKEMA. I think they do.

Mr. MONKS. The difficulty is that there has been such a proliferation of popular tax-aided savings programs that these have a very high tax cost, which in the popular imagination are charged to retirement income. As I mentioned in my prepared remarks, I think unfairly. I think in a lot of cases these are for other purposes than retirement income.

But it is a very high cost, and I think by focusing on trying to make tax-aided savings available to a wider spectrum than simply those now who are easily organized according to their employers' plans would give people a chance to provide for themselves that they don't presently have.

But as a practical matter, we are discriminating against the people who don't have easy access to tax-aided savings plans and we are making them do it the old-fashioned way, and that is after paying taxes, but that is in a sense a discrimination of 50 percent.

Mrs. Roukema. Thank you.

Mr. Grubbs. I agree with Dr. Carter that the lack of coverage is the most serious problem we face and I agree with the President's Commission that the only way we are really going to solve that problem is to have a mandatory universal pension system, which I support. However, I know it is not going to be passed this year.

There are things that we look at as disincentives, though. One is the IRA's. For the owner of a small business, if he puts money into an IRA for himself, every penny of it goes to himself. He doesn't have to spend a nickel on an employee. If he sets up a pension plan that covers him, he has costs for his employees, too.

The existence of the IRA as an alternative gives him an incentive to do that, to take care of himself in a way, with no cost for employees, and it provides a disincentive to establish a pension plan. Only the little employer who wants to set aside more than he can under an IRA has an incentive to establish a pension plan covering the employees.

If we raise the limit on IRA's we will make that problem worse.

The second thing I would like to say on disincentives is that the regulatory overkill and the complexity of the present laws and regulations has been a real disincentive to employers. There is a lot of cost related to that which is unnecessary.

While I am an advocate of more substantive protections for workers, like 3-year vesting, the complexity that we have in the existing laws and regulations is just beyond the comprehension of anyone who hasn't struggled with it. I challenge any Member of Congress to take a pension plan document which has been approved by the Internal Revenue Service for use under prototype plans, which are designed for small employers, to read it and tell me what it means. It complies with all the regulations, but no one could understand it.

The cost of the paperwork burden connected with these plans is simply too high, and even under existing law could be reduced.

Mrs. Roukema. Mr. Monks, do you agree with him on the IRA question?

Mr. Monks. Yes.

Mrs. Roukema. You do. That was the reference you made earlier when we couldn't hear you through the microphone; is that correct?

Mr. Monks. Yes.

Mrs. Roukema. All right.

Mr. Ross. If you would like a little dissent on the IRA thing, I would provide that.

I think a lot of the criticisms of the IRA's are well placed, but I would submit to you the question is do you want to "throw the baby out with the bath water" here? The United States historically has the lowest rate of personal savings of any industrialized country in the world.

For better or worse, the IRA has captured the imagination of a lot of people, perhaps because the people selling it have given it a lot of publicity, but nonetheless, there is something there that ought to be utilized and not cast aside.

I would be for an IRA reform bill that builds on the fact that it is beginning to capture the imagination of the public. Perhaps it could be reconstituted in a way where it was targeted better, where it was more widely available, where the equities of it were improved, and where it was tightened up so that it really represented a savings for retirement as opposed just to a capital accumulation plan.

It is too loose now, but like many other things which we have done as social policy or tax policy, it is ready for a wave of reform; it is not ready for repeal.

Mr. CLAY. Will the gentlewoman yield?

Mrs. ROUKEMA. Yes.

Mr. CLAY. Isn't the cost of the IRA's horrendous in terms of tax expenditures? I am told that if we increased it from $2,000 to $2,500 that that would cost $3 billion. Is that correct?

Mr. ROSS. I don't know about those figures. I am sure that if you did increase it, it involves large money. I would not increase it without a substantial reform program to make sure that it was more equitable in terms of its accessibility, and that it was more tight in terms of it not simply being a way to get a favored form of savings.

If you make the right adjustments to it, I think it does have the potential to meet some of the income security needs of the country. I would submit to you that it has one great virtue, which is, everything we are talking about is very group oriented. Social Security is a national social insurance program. Employee sponsored pensions are also very group oriented. This brings a lot of sense of individual responsibility to savings in making retirement provisions, and frankly, in today's world you don't get individual savings unless there are tax incentives and an institutionalized way of making the saving.

So while I am not going to defend the IRA's as presently constituted, I would strongly caution that what we need here is reform, not repeal.

Mrs. ROUKEMA. Thank you. Mr. Carter?

Mr. CARTER. In my opening remarks, I did attempt to itemize the things that I thought were impediments and they have been touched on now, so I won't belabor that again.

I would say, however, that we emphasize only the bureaucratic aspects of the administration of programs and the hope that some way would be found, and that is why I referred to the possibility of this notion of a portability fund serving the purpose, for administration, of an employer sponsored program, which would take a lot of the need for redtape away from the individual business, particularly the very small businesses which don't have significant management staffs and certainly don't want to spend what money they have on this aspect of management.

As far as the IRA issue is concerned, I think it is unquestioned that as it exists today that it is counter-productive as far as retirement policy is concerned. I think we make a mistake when we mix up the two things.

While retirement savings are an important part of savings, it is certainly arguable that the employer contribution is a major part of savings right now, because that is money that otherwise presumably, some significant portion of it at least, would be paid to employees in the way of salary. So that may be called forced savings at the retirement level.

It may be that we need, as other countries do, to encourage other savings, but that is really outside of the scope of talking about retirement savings as such. So I am not sure that I would like to see all savings favored in the retirement form because I am not sure that meets sufficiently all of the needs of the life cycle of human beings.

Here we are focused on retirement savings, and for those purposes I think the IRA's are a bad idea.

Mrs. Roukema. Thank you very much, Mr. Chairman.

Mr. Clay. Mr. Chandler.

Mr. Chandler. Thank you, Mr. Chairman.

Mr. Monks, I think I will direct this to you, and then the others can make some comments.

I believe you deserve a lot of credit for us even taking this issue on, and as I listened to the comments I have to remind myself that we are not the Ways and Means Committee here and we are not going to change these tax laws that we are talking about specifically.

What we really are talking about, though, is a national retirement income policy and a policy act. So while you made your statement that not having a policy constitutes having a policy, we have obviously evolved into that. We can continue evolving if we want to or we can develop a policy. What form should a policy take? Where do you put it and what ought to be in it?

For example, Mr. Ross raised the question. We know what the expectation is in terms of final retirement income, what percentage of final income ought to be. Sure, we know what people want, but should the policy address this and, if so, what would be the appropriate goal?

So if you could address yourself to that, and I don't mean to be critical by these remarks, but while we can't write tax law we can write this policy.

Mr. Monks. I am very grateful for the compliments, both expressed and implied, but I will do the best I can.

Just focusing on one aspect of a retirement policy, and that would be the portion of it that is single-employer plans or multiemployer plans for that matter, I feel that one of the areas in which an expressed policy would be helpful, it would be economical and it would enhance retirement income certainty and, I think, levels would be with respect to the goals being explicit for the portion that is provided by employer-funded plans, by which I mean under present policy there is no criteria for a percentage of preretirement income that is to be achieved, there is no notion of whether inflation should be compensated for.

Indeed, we know that only some 3 percent of the private employer plans have expressed recognition of inflation and have an undertaking by the company to take inflation into account.

We therefore now have a fairly open-ended commitment by companies under these single-employer plans that they, on the first instance, will try to meet the actuarial standards. Well, under circumstances prevailing in the country today and for the last 2 or 3 years, the preponderance of American companies could meet their actuarial assumptions by buying government bonds.

In doing this, there would be a level of certainty, there would be a decrease of transaction costs and there would be a fixity of that portion of the retirement income package.

On the other hand, we know that the preponderance of these moneys are apt to be invested in common stocks. This, of course, is a higher level of risk, and for whose benefit is that risk being taken? The company hasn't committed itself to pay more than an amount that it could fund by bonds, so the level of risk that is being taken is presumably being taken for the benefit of the company.

If the company were willing to commit itself to inflationary changes, then this increased level of risk might be justified. But I think at the moment, without there being an expressed guideline by yourselves as to whether there is to be a level of preretirement income and as to what adjustment for inflation is to be made, there is a very inefficient investment policy which does not work exclusively for the benefit of the participants of the plan, which is what the ERISA law requires.

Mr. Ross. Could I just add a little something there?

Mr. CHANDLER. I would appreciate it.

Mr. Ross. I think that what is needed is an explicit statement by Congress that addresses itself to the fact that our retirement income policy is based on having a set of building blocks.

Everybody throws around the three-legged stool cliche. I would submit to you it is a very poor analogy. What we really have today is a pluralistic policy in which you have public programs such as Social Security, you have private pensions, you have SSI and other welfare programs, and you have individual savings, those that are tax subsidized and those that aren't.

There is a whole myriad of things, at least seven or eight of them, that ought to be addressed in which there ought to be explicit guidelines as to how they fit together and what their relative importance is.

I think it is important to establish the preeminence of Social Security. It is also important to come realistically to grips with how far you can push the private pension system to supplement it, and that issue has to be bit into. I do not agree with the people on the panel who go toward mandatory private pensions. At the point you do that, you will swing very many people into saying, "Let's just expand Social Security." If you have a mandatory system, it delivers benefits there in an efficient way.

If you are going to turn the private pension system into that, I think you are subverting some of the virtues of it. And then I think you need a much larger component than today of individual savings and forcing individuals to feel their own responsibility for their retirement.

One of the really strong trends of the last 50 years is to give people the idea that the Government, the employer, somebody else, is going to take care of it, and they don't have to worry about it that much. The Government ought to reverse that psychology in part and say, "Hey, the Government will do a lot, employers can be expected to do a lot, but individuals have to do a lot for themselves."

All of this needs to be articulated by people like you, so that it gets public attention and political consensus.

Mr. CLAY. The time of the gentleman has expired.

Mr. Kildee?

Mr. KILDEE. I have no questions, Mr. Chairman. I thank you.

Mr. CLAY. Mr. Fawell.

Mr. FAWELL. I have really just one question. Mr. Grubbs, you made the statement that we should not cut back in regard to the cost of living on Social Security. Suppose we had double-digit inflation again.

Would what we have right now in terms of cost-of-living increases again put Social Security back on the road to bankruptcy, or bankrupt it?

Mr. GRUBBS. Social Security funding is a very long-term thing. Any changes in the long-term assumptions have to be looked at collectively; not only the cost-of-living change, but the rates of salary change. It is a very complex subject which would require studies to know whether that would improve or make worse the funding of Social Security.

Mr. FAWELL. But in your opinion—as I understood it, and I am a newcomer here—the double-digit inflation that we sustained in 1978, 1979 and 1980 took all the actuarial prognostications and just bombed them out, and we found Social Security going into a nosedive.

Do we have that potential again?

Mr. GRUBBS. There is always potential that the assumptions used are not going to be met, and the Social Security Administration in fact produces four alternative projections on what they call optimistic and pessimistic assumptions. It is very difficult to know in the long term what the experience is going to be.

Fortunately, because the program is long term, its solutions can be met gradually over a period of time; as over a period of years the tax rate could be modified slightly, the retirement age could be changed if necessary, but whatever changes are made in Social Security should be made on the basis, as they were in 1983, of a thorough study of the long-term financial needs of Social Security and not because of 1985's budget.

Mr. FAWELL. I might say also that I appreciated your comments about the fact that the deficit is not, that as far as the cost of living, a decrease for instance would not really help the deficit, because I, too, have always felt that those taxes at least are supposed to be guided by a trust fund basis, and that if we have a surplus that we are now told is possible, that this cannot help the deficit.

And yet many times when I have talked to some economists on this point, they just point to the bottomline of the deficit of the budget and say that because we have the unified budget, that that reasoning does not make sense. But I am glad to have your comments to the contrary.

Mr. GRUBBS. I think it would help if Congress changed to the prior concept of looking at the Social Security budget as a separate thing from the other Federal expenditures and sorting out the budget, as was done in prior years.

Mr. FAWELL. Thank you.

Mr. CLAY. Mr. Bartlett?

Mr. BARTLETT. Thank you, Mr. Chairman. I apologize to the panel for being late. I will be taking copies of your testimony and reviewing them. I think that the purpose of the hearing is excellent, and the witnesses are providing some helpful information.

It seems to me on the subject of national retirement income policy, that perhaps what we are seeking or what we ought to seek would be opportunities for individual retirement policies for the Nation as a whole. After all, all of the funds for retirement for any individual are going to come from the funds of that individual, either through his employer, his employee, or himself personally, his income, or his taxes; either saved directly or at least withdrawn from consumption during his or her working years. And so I think that whatever we end up doing over the long haul, I do hope that we keep the concept of individual choice first and foremost.

My question would be for Mr. Monks and perhaps some of the others would like to respond also. We have heard a great deal of criticism from small business in particular, and it seems to me to be well justified, about the frequent changes of the laws and the regulations for both defined benefit and defined contribution plans. While those changes, many of which I supported in the last session of Congress in particular, while those changes are positive, necessary and equitable, oftentimes the changes themselves cause employers to withdraw from defined benefit and defined contribution plans.

Do you see that as a major problem affecting retirement policies of individuals for the next 30 years, and if so, do you think the Congress should take more care to keep our changes prospective rather than retroactive in applying to existing plans?

Mr. MONKS. Congressman Bartlett, I feel that the level of changes does constitute a substantial burden. It constitutes a great difficulty for this body and for the Congress as a whole, because you have to match public policy considerations.

When you consider that there has been a major change in pension policy or tax policy as the ranking member pointed out, each year I guess, for the past 5 years that has required changes in the summary plan descriptions that are circulated; that each company has had to recalculate benefits in connection with the Pension Equity Act; that there have been substantial changes requiring new paperwork, new distribution.

The policy goals have to be balanced between putting people on notice of the exact and current nature of the law and the cost of doing so.

Mr. BARTLETT. So would you recommend that Congress make some sort of a commitment that changes will be prospective rather than applying to existing plans? Or is that feasible?

Mr. MONKS. I would not have the temerity to do that, Congressman.

Mr. BARTLETT. I hope someone does eventually.

Mr. MONKS. Congress usually, you know, makes up its own mind without advice from former bureaucrats.

No, obviously the best of all worlds; you open up ERISA once every 10 years and everybody puts in the right amendment, you shut up for 10 years. But that is very unlikely to happen.

Mr. BARTLETT. If we were to do that, would that cause more defined benefit and defined contribution plans to exist than would if we continue to change it every year?

Mr. MONKS. That would encourage the formation of retirement income plans.

Mr. BARTLETT. So there would be more plans rather than fewer plans?

Mr. MONKS. Yes, sir.

Mr. BARTLETT. Any of the other panelists?

Mr. CARTER. I would only observe that one of the reasons for the frequency of change is the absence of a policy. It is like sailing a boat; we do not know exactly where we are going; we have no idea, so we keep tacking.

It seems to me that if Congress is able to develop and agree upon a policy, this will make it much easier for business to respond within that framework and know where they are going over time without constant struggle.

Mr. ROSS. I would be so bold as to suggest here that you cannot ever freeze and grandfather anything safely in this area, whether it be Social Security, private pensions or anything. I think we are all learning; I think society changes; I think individual values and social values change; I think the Congress has to be prepared to adopt enlightened policies; it ought to provide reasonable transition rules to let people come into compliance with what evolves as presumably new and better policies, but I do not think you can say to people that somehow because you put something in place before we knew what we were doing, you are grandfathered for all time.

This area just does not lend itself to that kind of concept.

Mr. BARTLETT. Do you have any sort of quantative definition of reasonable transition rules?

Mr. ROSS. It would depend on the nature of the change. I mean, for example, you are going to have this problem in spades with the comprehensive tax reform if it happens, and particularly with respect to the changes that take place in employee benefit and income security areas, and it is going to go item by item.

Mr. GRUBBS. Having to amend your plan annually is an unreasonable expense and a real burden. A solution to that is to provide more lead time with any amendments so that when a change in rules is made, for example, nobody has to comply with it for four years. Then we might have changes made every year, but nobody would have to amend their plan more often than every four years.

Mr. CLAY. Thank you. Members of the subcommittee have a number of questions we would like to submit to you in writing, and particularly some dealing with our own retirement plans.

We certainly want to thank you for appearing today, and it was excellent testimony.

Senator Javits has submitted a statement for the record, and despite his recent and continuing illness, he dictated this statement yesterday. So, without objection, we would like to put it in the record at this point.

[Prepared statement of Senator Javits follows:]

Congressman WILLIAM L. CLAY,
Chairman of the Subcommittee of Labor-Management Relations, Committee on Education and Labor, U.S. House of Representatives, Rayburn House Office Building, Washington, DC.

DEAR MR. CHAIRMAN: In response to your oversight hearings on employee benefits and the need for a national retirement income policy, and speaking as one of the authors of ERISA, I make the following statement:

Let us remember that President Reagan took a position on not reducing Social Security but not on private pension and health and welfare plans, which now cover almost one half the U.S. work force.

Let us remember too that in the first four years of this Administration the tax inducement to establish and maintain private pension and health and welfare plans has already been materially nibbled at.

Let us note too that in the plan just submitted for tax simplification by the Treasury Department the private pensions system is even more seriously threatened.

A struggle is shapping up at the White House and on Capitol Hill on what can become this major domestic issue. This struggle will not be won without the morale among U.S. workers and in the pension community which is based on the principle that animated ERISA. That principle is that business should carry the main responsibility for the success of the retirement policy of the United States and of business itself. It is this issue which I believe your Subcommittee must face in its recommendations to the President and to the Congress on ERISA.

In this spirit, I reiterate my recommendations of September 12, 1984 as follows:

The integration of pensions under ERISA with Social Security, especially for workers in the lower brackets, should be reviewed and adjusted;

Withdrawal of assets of overfunded plans, especially to finance takeovers or opposition to takeovers, should be the subject of consideration for legislation;

Management of pension funds and the "prudent man rule", as well as so-called "public investment" of pension fund resources, should be reconsidered in the light of today's financial opportunities and the securities markets;

Participation by workers in pension fund management should be considered as a mandatory requirement;

Whether we can do better than we are now (roll-overs into IRA's) in terms of portability than we were able to do in ERISA in 1974;

A material increase in the premiums per worker paid to the Pension Benefit Guaranty Corporation;

And finally, as to the prohibited transaction section, I urge a four-part program, i.e.: the prohibited transaction provisions should be maintained, penal tax provisions should be maintained, penal tax provisions should be removed, double damages should be permitted for civil remedies under this section, and a limit of 90 days should be imposed on decision-making under this section.

I wish also to support the recommendations of the Pension Forum, a voluntary group of experts who reported to the Secretary of Labor last fall, as follows:

Information Handling;

Enforcement and the necessary hiring authorities for lawyers as investigators;

Rule-Making and Exemption-Granting, including the creation of a Self-Regulatory Organization (SRO) by the pension industry;

an Office of Pension Statistics;

the encouragement within the OPWPB of a Pension and Benefits Commission (PBC);

and new efforts to devote resources for Public Outreach and assistance;

I find them to be acceptable and constructive.

ERISA was a great milestone for our country in fundamental living and security for those of advancing years, and established a great sociological principle of business responsibility for the people's retirement income. All of those in Government responsible for its administration, as well as those in the pension industry and in the executive direction of the nation's business, have a sacred obligation to the people of our country to keep ERISA viable, honest and successful.

They also have a great opportunity to see that business in this field of retirement is carrying on in the public interest. The true test of this policy will also be meaningful to the individuals responsible for administering and providing pension and health and welfare plans in terms of the satisfaction and reward they should feel for the gratitude of their fellow Americans.

Sincerely yours,

JACOB K. JAVITS.

Mr. CLAY. The next witness is Mr. Robert Georgine, Chairman of the National Coordinating Committee on Multiemployer Plans.

STATEMENT OF ROBERT GEORGINE, CHAIRMAN, NATIONAL COORDINATING COMMITTEE ON MULTIEMPLOYER PLANS

Mr. CLAY. Welcome to the committee.

Without objection, your entire statement will be placed in the record at this point. We would appreciate it if you would be concise in giving it, but you may proceed as you see fit.

Mr. GEORGINE. Thank you very much, Mr. Chairman.

I will cut out quite a bit. I think for purposes of expediting the testimony, I will just get right to the meat of what I think is the serious issue that has to be discussed this morning.

Most recently, Treasury has released proposals that would impose tax burdens on essential employee benefits. Several Members of Congress have proposed tax reform bills that would impose similar burdens.

The Treasury proposal would impose additional taxes on the income of employees beneficiary associations and supplemental unemployment compensation benefit trusts. It would cap the amount of employer-paid health coverage that can be provided on a tax-exempt basis. It would repeal the exclusion from employee income of the cost of employer-paid group term life insurance, death benefits, group legal services. It would also impose additional taxes and early retirement benefits.

It is also alarming to note that while Treasury would impose additional tax burdens on this wide array of employee benefits, it would increase the favorable tax treatment available for IRA's. The policy underlying this decision is an extremely dangerous one.

Defined contibution plans such as IRA's, section 401(k) plans and ESOP's simply cannot provide the financial protection and security that is available through defined benefit pension plans.

Indeed, these plans are an essential component of a national employee benefits policy, and we must continue to do all we can to assure that defined benefit plans remain vital and healthy.

While it is apparently more fashionable these days to focus attention on the various types of defined contribution plans, the facts are that defined benefit pension plans have remained popular and are growing. This is true both in terms of single and multiemployer plans.

The reasons for this continued growth are clear: A defined contribution plan may help certain employees save a specific sum of money to be available for numerous contingencies, only one of which may be retirement. Even an IRA can be tapped by an employee prior to his retirement years. Thus, defined contribution plans are merely a form of savings. There are several other ways in which defined benefit pension plans are superior to defined contribution plans.

First, defined benefit plans provide strong incentives for a worker to remain with his or her employer. Or, in the case of multiemployer plans, to remain in the trade or the craft covered by the plan. This makes for a stable and a skilled work force which contributes to our economy as a whole.

Moreover, defined benefit plans encourage a more systematized approach to retirement in that there is a direct and positive correlation between the level and timing of pension benefits and the age at which workers retire. A regular monthly check payable at a definite time is a far more powerful retirement incentive than a one-time receipt of an undeterminable lump sum.

Second, defined benefit plans can be adapted by employers to a wide variety of circumstances. Most important of these is the ability, through a defined benefit plan, for an employer or group of employers to provide meaningful levels of benefits for older employees by granting past service credit.

Third, as pooled investment vehicles, defined benefit plans can use their large assets in ways which are simply unavailable to managers of defined contribution plans. The structure of defined benefit plans allows a plan sponsor to know what it will need during any specific time period, thereby assuring greater flexibility in making investment decisions; flexibility which allows for more creative uses of pension assets and higher returns over the long run. This, in turn, means the possibility of benefit increases and lower or more stable employer contribution obligations.

Finally, if for some reason investment returns or the ability to make contributions fall short of the need to pay promised pension benefits in a defined benefit plan, it is the plan sponsor—not the individual plan participant—who will bear the deficiency because the promised benefit must be paid. And, if the plan sponsor cannot meet its obligations, title IV of ERISA guarantees the payment of benefits through the pension guaranty program which, in essence, puts the community of all defined benefit plan sponsors behind the promise of each individual plan.

Thus, the apparent preference for IRA's over employee benefits, particularly defined benefit plans, represents an additional example of the alarming trend to undervalue the enormous social importance of employee benefits when deciding matters of tax and pension policy.

Several factors appear responsible. First, the continuing Federal deficits have created intense revenue pressures. Reducing the tax-favored status of employee benefits appeals to some as a low-visibility way to generate additional revenues. In our view, however, this Nation cannot justify any attempt to balance the Federal budget on the backs of working men and women of this country. Our workers and their families depend on retirement, health care, disability, life and unemployment insurance benefits provided by these plans. More equitable and humane ways of raising revenue exist than curtailing or eliminating these benefits.

Moreover, attempting to raise revenues in this manner is likely to be counterproductive. The curtailment of supplementary unemployment benefits, for example, would likely impose substantial additional pressures on federally funded or assisted welfare and unemployment programs.

Cutbacks in the provision of pension benefits would create even more obvious participant needs. The loss of such benefits would also likely result in significant grassroots pressure for new programs involving direct Federal spending.

Existing Federal tax incentives provide an efficient, cost-effective incentive for the provision of these essential benefits by the private sector. Substantial curtailment of these incentives would represent shortsighted and ineffective economic planning.

A second reason for the restrictive legislative trend may be the instances of reported abuse—for example, doctors and other professionals arranging for yachts to be contributed to a purported benefit plan. To the extent that such abuses actually exist, the Coordinating Committee has no interest in protecting them. However, we believe that actual abuses must first be carefully and precisely identified and that any remedy must be carefully tailored in order to excise only the abuse situation.

Abuse surgery that cuts deeply into healthy tissue, for example the recent VEBA legislation, has already worked unnecessary and unfair hardships on participants in legitimate benefit plans. In this connection, we are aware of no abuse in collectively bargained plans, and no such abuse has been reported. It has long been established that the very nature of the collective bargaining process—where employer and employee have a healthy adversity of economic interest—precludes the kinds of abuses that may exist elsewhere.

All other things being equal, an employer's economic interest does not lie in making excessive contributions to employee benefit plans. While contributions are in the employee's interest, employees generally want contributions limited to what is necessary to fund the benefit involved.

A dollar in additional employer contribution generally means a dollar less in wages. Moreover, multiemployer plans are jointly trusteed, so that this healthy adversity is reflected in the administration of such plans.

Finally, collectively bargained plans do not selectively provide benefits to owners or highly compensated individuals, thereby posing discrimination problems, as is generally recognized by the antidiscrimination provisions of the Internal Revenue Code.

Thus, in our view, the perception of abuse or abuse potential offers no justification for new restrictions of any kind on collectively bargained benefit plans. Apparent abuses in one sector should not be used as a smokescreen for revenue-motivated cuts in a nonabusive area.

In this regard we note that the House and Senate Labor Committees have a familiarity and expertise on collective bargaining issues that are not shared by all members of the tax-writing committees. We believe that your effective exclusion from the legislative consideration of these issues has produced many unfortunate results, and should not continue.

A third rationale sometimes advanced for restrictions—for example the proposed tax cap on health care benefits—is supposedly grounded in principles of efficiency and cost containment. Extend the incentive to a flat dollar amount, the theory goes, and actual health care costs will magically shrink to stay within the limits. Lower health care costs would benefit everyone, except perhaps the health care providers, and important social policy and Federal revenue considerations would thereby be served.

This of course is a pure pipe dream. The actual result would be that taxation of medical benefits for many middle- and low-income workers. Had the $175 per month cap proposed last year actually been adopted, one study conservatively estimates the following: 35 percent of the union-represented employees covered by multiemployer plans would have been subject to an average of $145 per year in additional tax. Some employees in the study would have owed nearly $500 in additional tax. In this respect, cost containment is nothing more than a pleasant euphemism for the imposition of taxes on health care benefit programs.

Moreover, the efficiency and cost containment arguments have generally ignored the substantial, historical contributions of collectively bargained plans in these areas. Such plans pioneered experimentation with health care delivery systems designed to provide care efficiently and at low cost.

These plans were among the first to utilize health maintenance organizations, second opinions on the necessity for surgery, and dental clinics. This experimentation has continued outside the health care arena, as our plans' experience with legal services programs amply demonstrates.

The Coordinating Committee believes that any reappraisal of the tax incentives presently afforded to employee benefit plans should not lose sight of these central facts.

Thank you very much.

[Prepared statement of Robert Georgine follows:]

PREPARED STATEMENT OF ROBERT A. GEORGINE, CHAIRMAN, NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS, WASHINGTON, DC

Mr. Chairman and members of the subcommittee, it is, as always, a pleasure to appear before you today to discuss the vital subject matter of these hearings—employee benefits and the need for a national employee benefits policy. I appear here today in my capacity as Chairman of the National Coordinating Committee for Multiemployer Plans (the "NCCMP"). The NCCMP was organized shortly after the enactment of ERISA, ten years ago, in order to represent the interests of the more than eight million working men and women, and their families, who are covered by multiemployer employee benefit plans. The Coordinating Committee's affiliates include more than 140 pension funds, health and welfare funds and related international unions.

I applaud you, Mr. Chairman, for having the courage and wisdom to keep these issues in the forefront of the national debate on domestic priorities. Indeed, there is no subject which is of greater importance to America's workers today, especially in view of the apparent willingness among certain policymakers to consider legislation which would effectively cut back or outright eliminate these benefits that workers have earned for themselves and their families.

The NCCMP and its affiliates are deeply concerned about the contained viability of collectively bargained employee benefit plans. These plans provide a wide range of essential benefits to tens of millions of Americans who otherwise could not afford them. They provide financial security necessary for employees to live in dignity after retirement. They permit employees and their families to meet medical expenses during times of crisis and encourage preventative health care. They protect dependents against financial disaster in the event of an employee's premature death. They provide funds for basic necessities for unemployed and disabled workers and their families. They provide meaningful access to legal services for many lower- and middle-income Americans, who could not otherwise afford the legal assistance necessary to protect their rights.

As AFL-CIO President Lane Kirkland testified before you just two weeks ago, America's private system of encouraging the untaxed diversion of a part of each worker's wages to meet certain critical human needs such as health care, education, life, disability and unemployment insurance and retirement security is fundamental to a stable, progressive society.

We have made enormous progress during this century in fashioning a national policy of fostering these benefits through a combination of public and private programs. On the public side, the establishment of the Social Security system and its expansion from a retirement and disability income maintenance program to a program also encompassing the provision of basic health services for the elderly and poor is, of course, fundamental to this national employee benefits policy. But Social Security, Medicare and Medicaid only offer a benefit floor. It is the private system of employer financed employee benefits which has nurtured the well-being of the vast majority of American workers and their families.

Nonetheless, a disturbing trend appears to be developing to curtail the incentives that have played a key role in the development of such benefit plans. Most recently, the Deficit Reduction Act of 1984 imposed new limits on contribution deductibility and subjected the earnings of employee benefit funds to new taxes on so-called unrelated business taxable income. That Act also repealed the estate tax exclusion for benefits paid from pension plans. Before that, the TEFRA legislation subjected pension benefits to withholding taxes and imposed other restrictions and burdens on employee benefit plans. There have been several major efforts, so far unsuccessful, to impose a "cap" on health care deductions or, alternatively, to include a portion of an employer's payments for health care in the income of the beneficiary.

Most recently, Treasury has released proposals that would impose tax burdens on essential employee benefits, and several members of Congress have proposed "tax reform" bills that would impose similar burdens. The Treasury proposal would impose additional taxes on the income of employees' beneficiary associations and supplemental unemployment compensation benefit trusts. It would cap the amount of employer-paid health coverage that can be provided on a tax-exempt basis. It would repeal the exclusion from employee income of the cost of employer paid group term life insurance, death benefits, and group legal services. It would also impose additional taxes on early retirement benefits.

It is also alarming to note that, while Treasury would impose additional tax burdens on this wide array of employee benefits, it would increase the favorable tax treatment available for IRA's. The policy underlying this decision is an extremely dangerous one. Defined contribution plans, such as IRA's, 401(k) plans, and ESOP's, simply cannot provide the finanical protection and security that is available through defined benefit pension plans.

Indeed, these plans are an essential component of a national employee benefits policy and we must continue to do all we can to assure that defined benefit plans remain vital and healthy.

While it is apparently more fashionable these days to focus attention on the various types of defined cotribution plans, the facts are that defined benefit pension plans have remained popular and are growing. This is true both in terms of single and multi-employer plans. And the reasons for this continued growth are clear. A defined contribution plan may help certain employees save a specific sum of money to be available for numerous contingencies, only one of which may be retirement. Even an IRA can be tapped by an employee prior to his retirement years. Thus, defined contribution plans are merely a form of savings. There are several other ways in which defined benefit pension plans are superior to defined contribution plans.

First, defined benefit plans provide strong incentives for a worker to remain with his or her employer or, in the case of multi-employer plans, to remain in the trade or craft covered by the plan. This makes for a stable and skilled workforce which contributes to our economy as a whole. Moreover, defined benefit plans encourage a more systematized approach to retirement in that there is a direct and positive correlation between the level and timing of pension benefits and the age at which workers retire. A regular monthly check payable at a definite time is a far more powerful retirement incentive than a one time receipt of a undeterminable lump sum.

Second, defined benefit plans can be adapted by employers to a wide variety of circumstances. Most important of these is the ability, through a defined benefit plan, for an employer or group of employers to provide meaningful levels of benefits for older employees by granting past service credit.

Third, as pooled investment vehicles, defined benefit plans can use their large assets in ways which are simply unavailable to managers of defined contribution plans. The structure of defined benefit plans allows a plan sponsor to know what it will need during any specific time period, thereby assuring greater flexibility in making investment decisions—flexibility which allows for more creative uses of pension assets and higher returns over the long run. This, in turn, means the possibility of benefit increases and lower or more stable employer contribution obligations.

Finally, if for some reason investment returns or the ability to make contributions fall short of the need to pay promised pension benefits in a defined benefit plan, it is the plan sponsor—not the individual plan participant—who will bear the deficiency because the promised benefit must be paid. And, if the plan sponsor cannot meet its plan obligations, Title IV of ERISA guarantees the payment of benefits through the pension guaranty program which, in essence, puts the community of all defined benefit plan sponsors behind the promise of each individual plan.

Thus, the apparent preference for IRA's over employee benefits, particularly defined benefit plans, represents an additional example of the alarming trend to undervalue the enormous social importance of employee benefits when deciding matters of tax and pension policy.

Several factors appear responsible. First, the continuing federal deficits have created intense revenue pressures. Reducing the tax-favored status of employee benefits appeals to some as a low-visibility way to generate additional revenues. In our view, however, this nation cannot justify any attempt to balance the federal budget on the backs of the working men and women of this country. Our workers and their families depend on the retirement, health care, disability, life and unemployment insurance benefits provided by these plans. More equitable and humane ways of raising revenue exist than curtailing or eliminating these benefits.

Moreover, attempting to raise revenues in this manner is likely to be counterproductive. The curtailment of supplementary unemployment benefits, for example, would likely impose substantial additional pressures on federally funded or assisted welfare and unemployment programs. Cutbacks in the provision of pension benefits would create even more obvious participant needs. The loss of such benefits would also likely result in significant grass roots pressure for new programs involving direct federal spending. Existing federal tax incentives provide an efficient cost-effective incentive for the provision of these essential benefits by the private sector. Substantial curtailment of these incentives would represent short-sighted and ineffective economic planning.

A second reason for the restrictive legislative trend may be the instances of reported abuse—for example, doctors and other professionals arranging for yachts to be contributed to a purported benefit plan. To the extent such abuses actually exist, the Coordinating Committee has no interest in protecting them. However, we believe that actual abuses must first be carefully and precisely identified, and that any remedy must be carefully tailored in order to excise only the abuse situation. Abuse surgery that cuts deeply into healthy tissue, for example the recent VEBA legislation, has already worked unnecessary and unfair hardship on participants in legitimate benefit plans. In this connection, we are aware of no abuse in collectively bargained plans, and no such abuse has been reported. It has long been established that the very nature of the collective bargaining process—where the employer and the employee have a healthy adversity of economic interest—precludes the kinds of abuses that may exist elsewhere. All other things being equal, an employer's economic interest does not lie in making excessive contributions to employee benefit plans. While contributions are in the employee's interest, employees generally want contributions limited to what is necessary to fund the benefit involved. A dollar in additional employer contribution generally means a dollar less in wages. Moreover, multiemployer plans are jointly trusted, so that this healthy adversity is reflected in the administration of such plans. Finally, collectively bargained plans do not selectively provide benefits to owners or highly compensated individuals, thereby posing discrimination problems, as is generally recognized by the anti-discrimination provisions of the Internal Revenue Code.

Thus, in our view, the perception of abuse or abuse potential offers no justification for new restrictions of any kind on collectively bargained benefit plans. Apparent abuses in one sector should not be used as a smokescreen for revenue-motivated cuts in a nonabusive area. In this regard, we note that the House and Senate Labor Committees have a familiarity and expertise on collective bargaining issues that are not shared by all members of the tax-writing committees. We believe that your effective exclusion from the legislative consideration of these issues has produced many unfortunate results, and should not continue.

A third rationale sometimes advanced for restrictions—for example the proposed "tax cap" on health care benefits—is supposedly grounded in principles of efficiency and cost containment. Extend the incentive to a flat dollar amount, the theory goes, and actual health care costs will magically shrink to stay within the limits. Lower health care costs would benefit everyone (except perhaps the health care providers), and important social policy and federal revenue considerations would thereby be served.

This is, of course, pure pipe dream. The actual result would be the taxation of medical benefits for many middle- and low-income workers. Had the $175 per month "cap" proposed last year actually been adopted, one study conservatively estimates the following: 35 percent of the union-represented employees covered by multiemployer plans would have been subject to an average of $145 per year in additional tax. Some employees in the study would have owned nearly $500 in additional tax. In this respect, "cost containment" is nothing more than a pleasant euphemism for the imposition of taxes on health care benefits programs.

Moreover, the efficiency and cost-containment arguments have generally ignored the substantial, historical contributions of collectively bargained plans in these areas. Such plans pioneered experimentation with health care delivery systems designed to provide care efficiently and at low cost. These plans were among the first to utilize Health Maintenance Organizations, second opinions on the necessity for surgery, and dental clinics. This experimentation has continued outside the health care arena, as our plans' experience with legal services programs amply demonstrates.

The Coordinating Committee believes that any reappraisal of the tax incentives presently afforded to employee benefit plans should not lose sight of the central facts. First, such plans—particularly collectively bargained plans—have proven to be overwhelmingly successful arrangements for the private sector provision of essential benefits. Many of those for whom such benefits are provided have totally inadequate personal resources, and would otherwise fall back on the public sector. Efforts to improve on a system that is working so efficiently may sell well prove counterproductive.

Second, any so-called "reform" measures must be carefully directed, so as to cover only instances of actual abuse. Such measures should not result in restrictions on plans, like collectively bargained plans, where the perceived abuse cannot exist or is otherwise already regulated by ERISA and related laws.

Finally, questions of revenue loss, efficiency and cost containment must be considered in the proper context. Historically, collectively bargained plans have been innovative leaders and experimenters in providing benefits efficiently and at low cost. Moreover, the "savings" from curtailment of tax incentives in this area may well be illusory, as plan participants will necessarily look to alternate sources—primarily federally funded benefits programs.

Of course, the tax laws alone do not represent the only aspect of Federal law which impacts upon a national employee benefits policy. In 1974, the Congress enacted one of the most important pieces of public policy legislation even to emanate from the legislative process. That legislation—ERISA—was a clear statement of national policy that we must continue to encourage and foster employee benefit plans while at the same time assuring that the assets and resultant benefits of these plans are fully protected for the current and future enjoyment of plan participants. Congress said at that time that it is only through the private sector that we going to be able to assure meaningful levels of retirement, health, education and other welfare benefits. Congress said that these benefits are to be earned in the workplace and that the marketplace will determine how high or extensive these benefits will be. And Congress said once employers and employees establish various types of benefit plans, those plans will have to meet certain basic minimum standards so that the promise to pay those hard earned benefits is not illusory. When all is said and done, Mr. Chairman, that is what our national employee benefits policy is today—and it is as I have just described it. It is not perfect policy and will continue to require the kind of fine tuning that took place in 1980 with MPPAA and in 1984 with REA. Moreover, as the NCCMP has been urging for years, we need a more rational regulatory approach by placing all jurisdiction over employee benefit plans in one agency dedicated to the preservation and flourishing of employee benefit funds.

Once again, Mr. Chairman, I applaud your current effort to evaluate the current status employee benefits and to review our national employee benefits policy. To the extent that the NCCMP can continue to be helpful in the process, we are ready, willing and, as always available. If we are to succeed in this shared goal, we must look carefully at whether there is in fact anything wrong with the current system. If there really are significant problems with the present policy, those problems—and their solution—must be targeted with precision. However, we just avoid unnecessary tinkering that would jeopardize the health of the employee benefit system. If we stay true to this course, we can continue to hope for a credible non-partisan approach to employee benefit plan regulation.

Mr. CLAY. Thank you.

Mr. Georgine, do you believe that this Congress has an obligation to guarantee that benefits paid are used for retirement regardless of the type of plan, whether it is a defined contribution or defined benefit plan?

Mr. GEORGINE. Yes.

Mr. CLAY. You think that we ought to stop the practice of cashing out?

Mr. GEORGINE. I think the practice of terminating plans and recovering excess assets by employers ought to be discouraged, yes; stopped if possible.

Mr. CLAY. We have got a problem today with more people being more mobile in jobs. Now I know it does not affect your industry because you are protected under the multiemployer plan, but do you think that we ought to develop some type of portability system which will meet the needs of these people who work for several or many employers?

Mr. GEORGINE. I think portability really is a two-edged sword. But in most cases, and in the case that you are alluding to, I think it is imporant and it should be developed, yes.

Mr. CLAY. Mrs. Roukema?

Mrs. ROUKEMA. Mr. Georgine, thank you for your testimony. It comes as no surprise to you that it is quite consistent with the statements made by Mr. Kirkland last week.

Mr. GEORGINE. I would hope so.

Mrs. ROUKEMA. It just again demonstrates the juxtaposition, if not the actual interrelationship, of course, between what we are talking about here and the whole thrust of tax simplification and fairness and it again is another reminder that once one goes from the abstract to the concrete on tax simplification you have some very substantial problems to address.

Going now to the issue of retirement income policy, aside from those important points that you have made with respect to the taxation question, as a representative of multiemployer plan groups, what do you see as a primary area that we should address if we intend to adopt a national income retirement policy, from the point of view of our multiemployer pension plans?

Mr. GEORGINE. First of all, let me say at the outset that I believe there is a policy now. We have Social Security augmented by the private pension system. So I think there is a national policy with regard to retirement. And I think that it works reasonably well. I think that it is one that has worked well; it has its deficiencies of course, and they have to be perfected.

But generally speaking it is a good system. Having said that, I think that you cannot really separate the two; the tax policy proposals or the tax revenue-increasing proposals from what we are really talking about insofar as pension plan policy is concerned.

That is why I say that we have to have the inclusion of the health, education, and welfare committees to assure that there are people who understand the social problems that exist and we will have an eye out toward that without just looking at it as a dollar and cents kind of thing.

Mrs. ROUKEMA. Let me be specific in at least one area. Mr. Clay has already spoken about the portability issue, which does not necessarily involve your groups, but others; it is a very important question in terms of the population as a whole.

What about some of the other issues such as the vesting question? We have had some people come before us and suggest 3-year vesting. The vesting question and portability have to be addressed for maybe 50 percent of the population who are presently uncovered by any pension plans.

Do you have any suggestions or points of view from your industry's perspective on the vesting issue?

Mr. GEORGINE. I think to shorten vesting is not a wise policy. I think the vesting that we have right now, 10 year vesting I think makes sense. I think to shorten that any more would be a mistake.

I think that there has to be more emphasis put on the defined benefit kind of programs that we have. The purpose of those programs, and the purpose of pension programs to begin with was to provide added income to those when they are ready to retire; added beyond what Social Security gives them because obviously you cannot live on Social Security now.

In doing that, in setting up these plans, we knew full well that there would be people who would pay into it or that benefits would be paid in on their behalf; that they would never receive those benefits.

That is the way the plan is set up. I think to take that away or reduce that of course reduces the final benefits that people do receive, in the final analysis. I think that is good. I think there is a place for IRA's and there is a place for ESOP's and there is a place for all of those kinds of things, but I do not think that we should take away from or reduce the importance, as the atmosphere is today, to try and discourage everyone from getting involved in defined benefit plans. I think that is a mistake.

Mrs. ROUKEMA. Thank you, Mr. Chairman.

Mr. CLAY. Thank you.

Mr. Hayes.

Mr. HAYES. It is hard to find questions of someone you agree with. It is extremely difficult. I just want to make a comment, I guess, that it does disturb me; as the administration continues to shop around, it seems to me, for ways and means to increase the Government's income, thereby reducing this deficit, they tend to zero in on those who seem to be the most defenseless.

Your mentioning of the unfairness of attacking the programs looking for money from working people I think is really a fact and it is something that we have got to protect.

You mention in your statement: Our workers and their families depend on retirement, health care, disability, life, and unemployment insurance benefits.

I suppose you know that this week we have quite a struggle coming up to just extend unemployment benefits for 340,000 workers for a mere maybe 3 months.

More equitable and humane ways of raising revenue exist than curtailing or eliminating these benefits, you say.

I wondered if you wanted to elaborate a little bit on some of the more equitable ways.

Mr. GEORGINE. We might have to get into a discourse on tax policy.

Mr. HAYES. We may need to get into that. I am concerned about the direction we are going.

Mr. GEORGINE. I really do think that the Tax Code, you know, that more emphasis can be put on collecting taxes from those who are more equipped to pay it then trying to burden those people who are the workers in this country, and who get very small salaries and who pay the bulk of the taxes that support this country. I think that is what we have to deal with.

To try and take away the tax exemptions that we know have, that were the policy of this country, and help create these pension funds that do augment the Federal system, I think is a tragic mistake and one that affects mostly those people who can afford it the least. So, if you are going to make changes to get income into the Federal Government, make it where it really matters. Make those people who should be paying pay their taxes. Those that are paying now, give them some relief.

Mr. HAYES. I agree with you. We could spend less on defense, too.

Mr. GEORGINE. You could do that; you could do that.

Mr. CLAY. Mr. Chandler.

Mr. CHANDLER. Thank you, Mr. Chairman.

Mr. Georgine, you and Mr. Monks obviously agree on one really fundamental point, that being—and I will take it from page 4 of your testimony—"we must continue to do all we can to assure that defined benefit plans remain vital and healthy." I very much agree with that statement. However, I will tell you that almost everywhere I go, when I talk to people who might be considering a multiemployer pension plan, they tell me you would have to be crazy to go into one under the terms of the 1980 MEPPA. I want to know if you have any information that you would like to share with this committee that would indicate that the tendency toward creating multiemployer pension plans has not stagnated since the enactment of MEPPA in 1980.

Mr. GEORGINE. That is a very interesting and very good question because it is one that we have to deal with every day. I think that there are great smokescreens that have been puffed up in the sky about withdrawal liability, and its effect upon the pension system. Of course, in the construction industry we have an exemption. I think it is a good one and a fair one, and it is equitable. Really, there is no withdrawal liability in the construction industry and I maintain that very forcefully.

I think that that kind of exemption can be granted to other industries, and it should be; it should be enlarged upon. I think that that is the approach that a lot of these people who are complaining about withdrawal liability and its inhibitions and restrictions and constraints should be going. They ought to be going to the PBGC, and attempting to develop for their industries the kind of exemption we have in construction. I don't think it is inhibitive.

Mr. CHANDLER. In your testimony and in your response to Mrs. Roukema, I understood you to say that as far as you are concerned, ERISA constitutes a policy today. Am I to understand, then, that you would oppose the enactment of some form of policy—some guideline—perhaps, a preamble to ERISA?

Would you be opposed to some more fundamental policy structure under which we would make those decisions, addressing perhaps this question of percentage of final income for retirement purposes and so?

Mr. GEORGINE. No. I would not be opposed to that. I would have to look at it. But I would not be opposed to it; the idea; the concept.

Mr. CHANDLER. I think we were gaining that impression from your testimony.

Mr. GEORGINE. Oh, no.

Mr. CHANDLER. I appreciate your response.

Thank you, Mr. Chairman.

Mr. CLAY. Mr. Gaydos.

Mr. GAYDOS. Thank you, Mr. Chairman. I am not a member of this subcommittee, but I thought it was encumbent upon me to come here, Mr. Georgine, with your associates, and state for a matter of record that I am very happy to see you continually participating in your Government by yourself, and also on behalf of your organization. I remember back when some 15 years ago when ERISA was a concept, Mr. Georgine and his group were very active at the time. They presented formal testimony, they worked with the committee very closely, and followed through, both in practical and technical matters.

I want you to know that I took time today to come and listen to you again. I had informed Mr. Clay, the chairman of this subcommittee, that I would have time to try and participate because I am very interested in the subject matter. It is really good to see my old colleagues continually fighting the battle and participating in what I know is going to be a very important and necessary piece of legislation. We waited a long time to bring it up to date. So I want to thank you publicly.

Mr. GEORGINE. We want to thank you, Congressman Gaydos, for showing that interest and for being the kind of Congressman and legislator that is cognizant of the needs of working people and does everything he can to help them. We appreciate that.

Mr. GAYDOS. I want to thank Mr. Clay for allowing me to make those remarks.

Mr. CLAY. Thank you, Mr. Georgine, for appearing today. We benefited from your testimony.

Mr. GEORGINE. Thank you for having me, Mr. Chairman.

Mr. CLAY. Without objection, the summary of the report of the National Pension Forum will be placed in the record at this point.

[The information referred to follows:]

THE NATIONAL PENSION FORUM
of the ERISA Advisory Council

1974-1984

Room S4316, 200 Constitution Ave., N.W., Washington, D. C. 20210
Telephone: (202) 523-8574

Ann Colgrove, *Director*

Council Members:
Roy M. Brewer
John L. Casey, Jr.
Gerald D. Facciani
Gerald M. Feder
Leland S. McCullough, Jr.
James B. Miller
Myron J. Mintz
Charles A. Moran
Donald N. Pond, Jr.
Howard W. Ryder
Barbara W. Schlicher
Alfred H. Sigmon
Lawrence T. Smedley
James H. Sourbeer
Josetta H. Srb

INTRODUCTION

On September 2, 1974, the Employee Retirement Income Security Act (ERISA) was signed into law, marking a new era in pension reform. In this year of ERISA's tenth anniversary, the Secretary of Labor established the National Pension Forum as a means by which to undertake an objective, bipartisan review and analysis of the Department of Labor's effectiveness in carrying out its administrative responsibilities under Title I of ERISA.

Comprised of members of the Executive and Legislative branches of the government and representatives from the pension industry, organized labor and the general public, the Forum was requested to review the Department's responsibilities under Title I of ERISA, as well as its performance of those responsibilities during the last ten years. Based on information gathered from public hearings and work sessions, the Forum's mission was to prepare recommendations for administrative and legislative changes necessary for a more efficient and effective pension program within the Department.

Among the areas identified by the Secretary for the Forum's study were the following: methods by which the Department's data base on pension and welfare plans might be enhanced; the Department's enforcement programs; the continuity of Departmental regulations; the computerization of financial information maintained by the Department for public disclosure; the filing of annual report information electronically; and methods by which the processing of individual exemptions from ERISA's prohibited transaction provisions might be facilitated.

The following report represents the work and the recommendations of the National Pension Forum.

NATIONAL PENSION FORUM PARTICIPANTS

Honorary Chairman

The Honorable Jacob Javits
375 Park Avenue
New York, NY 10022

Honorary Member

The Honorable John H. Dent
Law & Finance Building
35 West P.H. Street
Greensburg, PA 15601

Members of Congress

The Honorable Sala Burton
U.S. House of Representatives
1408 Longworth House Office Building
Washington, D.C. 20515

Mike Moran
Legislative Assistant

The Honorable John H. Chafee
U.S. Senate
523 Dirksen Senate Office Building
Washington, D.C. 20510

Catherine Porter
Legislative Assistant

The Honorable Rod Chandler
U.S. House of Representatives
216 Cannon House Office Building
Washington, D.C. 20515

Karen Graham
Legislative Assistant

NATIONAL PENSION FORUM PARTICIPANTS

Members of Congress (Cont)

The Honorable William Clay
U.S. House of Representatives
2470 Rayburn House Office Building
Washington, D.C. 20515

Phyllis Borzi
Counsel for Pensions
Subcommittee on Labor-Management Relations
Committee on Education and Labor
2451 Rayburn House Office Building
Washington, D.C. 20515

Fred Feinstein
Staff Director/Counsel

The Honorable Barber B. Conable, Jr.
U.S. House of Representatives
[illegible] Cannon House Office Building
Washington, D.C. 20515

Paul Auster
Assistant Minority Counsel
Committee on Ways and Means
1106 Longworth House Office Building
Washington, D.C. 20515

The Honorable Robert Dole
U.S. Senate
141 Hart Office Building
Washington, D.C. 20510

Richard Belas
Tax Counsel
Senate Finance Committee
[illegible] Dirksen Senate Office Building
Washington, D.C. 20510

NATIONAL PENSION FORUM PARTICIPANTS

Members of Congress (cont)

The Honorable John N. Erlenborn
U.S. House of Representatives
2206 Rayburn House Office Building
Washington, D.C. 20515

Russell J. Mueller
Minority Legislative Associate
Subcommittee on Labor-Management Relations
Committee on Education and Labor
112 Cannon House Office Building
Washington, D.C. 20515

Carolyn Sladek
Administrative Assistant and
Legislative Assistant
Office of Congressman John Erlenborn

The Honorable John Heinz
U.S. Senate
[illegible] Russell Senate Office Building
Washington, D.C. 20510

Anthony Knettel
Professional Staff
Senate Select Committee on Aging
G33 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Edward M. Kennedy
U.S. Senate
[illegible] Russell Senate Office Building
Washington, D.C. 20510

Mike Forsey
Counsel
Senate Committee on Labor
and Human Resources
428 Dirksen Senate Office Building
Washington, D.C. 20510

NATIONAL PENSION FORUM PARTICIPANTS

Members of Congress (cont)

The Honorable Barbara B. Kennelly
U.S. House of Representatives
1228 Longworth House Office Building
Washington, D.C. 20515

Christine Healey
Legislative Assistant

The Honorable Howard Metzenbaum
U.S. Senate
140 Russell Senate Office Building
Washington, D.C. 20510

David Starr
Legislative Assistant

The Honorable Don Nickles
U.S. Senate
713 Hart Senate Office Building
Washington, D.C. 20510

Rick Lawson
Co Chief Counsel
Subcommittee on Labor
Senate Labor and Human Resources Committee
428 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Mary Rose Oakar
U.S. House of Representatives
[illegible] Rayburn House Office Building
Washington, D.C. 20515

Marian Framin
Legislative Assistant

NATIONAL PENSION FORUM PARTICIPANTS

Members of Congress (cont)

The Honorable J.J. Pickle
U.S. House of Representatives
242 Cannon House Office Building
Washington, D.C. 20515

Barbara Pate
Legislative Assistant

The Honorable Dan Quayle
U.S. Senate
524 Hart Senate Office Building
Washington, D.C. 20510

Diann Howland
Professional Staff Member

The Honorable Edward R. Roybal
U.S. House of Representatives
2211 Rayburn House Office Building
Washington, D.C. 20515

Roger Thomas
Pension Counsel
House Select Committee on Aging
300 New Jersey Avenue, S.E.
House Annex I, Room 711
Washington, D.C. 20515

The Honorable Marty Russo
U.S. House of Representatives
1406 Longworth House Office Building
Washington, D.C. 20515

Bridget O'Keefe
Legislative Assistant

The Honorable Ron Wyden
U.S. House of Representatives
1406 Longworth House Office Building
Washington, D.C. 20515

Lois Lindsay Davis
Administrative Assistant

NATIONAL PENSION FORUM PARTICIPANTS

Government Agencies

Mr. Daniel Benjamin
Chief of Staff
U.S. Department of Labor
Washington, D.C. 20210

Mr. John Cogan
Associate Director
Office of Management & Budget
Old Executive Office Building
Room 246
17th & Pennsylvania Avenue, N.W.
Washington, D.C. 20503

Thomas Arthur
Budget Examiner
Office of Management & Budget
17th & Pennsylvania Avenue, N.W.
Washington, D.C. 20503

Mr. Thomas J. Healey
Assistant Secretary for
Domestic Finance
U.S. Department of the Treasury
Room 3321
15th & Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Gordon Eastburn
Director, Office of Finance
Institutes Policy

Patrick Garabedian
Financial Analyst

Mr. J. Brian Hyland
Inspector General
U.S. Department of Labor
Washington, D.C. 20210

Mr. Francis X. Lilly
Solicitor of Labor
U.S. Department of Labor
Washington, D.C. 20210

NATIONAL PENSION FORUM PARTICIPANTS

Government Agencies (cont)

The Honorable Robert A.G. Monks
Administrator
Office of Pension and Welfare
Benefit Programs
U.S. Department of Labor
Washington, D.C. 20210

Ann Colgrove
Special Assistant
to the Administrator

Janet Brown
Special Assistant
to the Administrator

Edward F. Lysczek
Executive Secretary
ERISA Advisory Council

Mr. William Niskanen
Member, Council of Economic Advisers
Old Executive Office Building
17th & Pennsylvania Avenue, N.W.
Washington, D.C. 20503

Kathleen Utgoff
Senior Staff Economist
Council of Economic Advisers

Mr. Charles C. Tharp
Executive Director
Pension Benefit Guaranty Corporation
2020 K Street, N.W.
Washington, D.C. 20006

Kevin Putt
Special Assistant
to the Executive Director

NATIONAL PENSION FORUM PARTICIPANTS

ERISA Advisory Council

Mr. Roy M. Brewer
Consultant
International Sound Technicians
P.O. Box 1726
Studio City, CA 91604

Mr. John L. Casey, Jr.
Partner
Scudder, Stevens & Clark
345 Park Avenue
25th Floor
New York, NY 10022

Mr. Gerald D. Facciani
President
Professional Plan Administrators
Incorporated
4411 Rockside Road
Cleveland, OH 44131

Mr. Gerald M. Feder
Feder and Edes
1527 18th Street, N.W.
Washington, D.C. 20036

Mr. Leland S. McCullough, Jr.
Partner
Greene, Callister & Nebeker
[illegible] Kennecott Building
Salt Lake City, UT 84133

Mr. James B. Miller
Partner
Deloitte Haskins & Sells
1114 Avenue of the Americas
New York, NY 10036

Mr. Myron J. Mintz
Partner
Epstein, Shapiro & Morin
2101 L Street, N.W.
Washington, D.C. 20037

NATIONAL PENSION FORUM PARTICIPANTS

ERISA Advisory Council (cont)

Mr. Charles A. Moran
Senior Vice President
Manufacturers Hanover Trust
  Company
Bank Window, Church Street
  Station
New York, NY 10015

Mr. Donald H. Pond, Jr.
Vice President & Actuary
Connecticut Mutual Life
  Insurance Company
140 Garden Street
Hartford, CT 06115

Mr. Howard W. Ryder
President
Central Tank Lines, Inc.
[illegible] North Cleveland -
  Massillon Road
Akron, OH 44313

Ms. Barbara W. Schlicher
Vice President and Trust Officer
Midlantic National Bank
499 Thornall Road
Edison, NJ 08818

Mr. Alfred H. Sigman
Attorney
[illegible] 14th Street
Room 1302
Oakland, CA 94612

Mr. Lawrence T. Smedley
Associate Director
Department of Occupational
  Safety, Health, and Social
  Security, AFL-CIO
815 16th Street, N.W.
Washington, D.C. 20006

NATIONAL PENSION FORUM PARTICIPANTS

ERISA Advisory Council (cont)

Mr. James N. Sourbeer
Vice President - Attorney
Marsh & McLennan Group Associates
2829 Westown Parkway
Suite 350
West Des Moines, IA 50265-1960

Ms. Jozetta H. Srb
Research Associate
School of Industrial
Labor Relations
Cornell University
Ithaca, NY 14853

NATIONAL PENSION FORUM

Recommendations for Action by Secretary Donovan

BACKGROUND

The National Pension Forum was organized by Secretary Donovan in early 1984 as one of the essential parts of his commitment to discharge as well as possible the obligations of the Department of Labor under Title I of ERISA. The Secretary instructed the Forum to propose administrative and legislative recommendations to improve the Department's ability to fulfill its statutory responsibilities under Title I, the most important of which is protecting the interests of participants and beneficiaries in private sector benefit plans. Other elements comprising the Secretary's commitment have included the separation of Pension and Welfare Benefit Plans (PWBP) personnel and operations from the Labor-Management Services Administration (LMSA). This process was effectively completed in August 1984.

The Forum is comprised of the statutory ERISA Advisory Council, members of both Houses of Congress and representatives from the Department of Treasury, the Office of Management and Budget, the Council of Economic Advisors, and the Pension Benefit Guaranty Corporation (the Executive branch agencies most directly affecting Labor's Title I obligations). The Forum met formally in June, September and December with working group meetings in October and November. The range of discussions has been broad - in some instances well beyond the original scope of the Forum's mission. It was felt that unfettered discussion would be helpful in generating the final recommendations because only in considering the scope of possible policy limits for Presidential or Congressional action would it be possible to have confidence in making recommendations to the Secretary for organizational focus. However, it is felt that the Forum's final recommendations should be consistent with the Secretary's instructions, and thus formal conclusions will be limited to matters concerned with Departmental organization. There is attached, however, a supplementary section of this report captioned "Policy", with which some members of the Forum, as indicated in the accompanying statements, wish to associate themselves.

FINDINGS

The public interest requires that the Department of Labor substantially improve its prior level of discharge of Title I of ERISA in the following areas:

1. Information Handling. The information contained in annual reports should be timely. Electronic information management is the only way to create an ERISA data base which will support effective enforcement of ERISA's substantive requirements, responsible discharge of the Department's research and policy obligations, and for public information purposes. The present situation is unacceptable.

2. Enforcement. A strong enforcement program is critical to the administration of ERISA. The current program is unacceptable and must be improved.

3. Rule-making and exemption-granting. The lead time necessary for granting exemptions is having an adverse effect on the American economy in preventing the increasingly large pools of capital subject to ERISA from being invested in areas where quasi-judicial action by OPWBP is necessary in order to authorize the transaction. The Forum appreciates the complexity of ERISA issues and applauds the quality of the

agency's professional work. However, the American economy needs to have access to ERISA funds on a timely basis, so either substantial additional personnel or new organizational devices will be necessary.

4. Policy. Up until the present time, OPWBP has not committed itself to providing the statistical and policy leadership required under section 513(a)(2). Resources should be made available and priority placed on this capability.

5. Culture. The obligations of the Department under Title 1 of ERISA require competencies of the highest professional nature - comparable to those of the SEC and the IRS, for example. It is, therefore, necessary organizationally to give OPWBP a sense of autonomy within the Department of Labor, perhaps modeled after the Bureau of Labor Statistics, which has an excellent reputation for the accuracy and integrity of its recordkeeping and the professionalism of its staff.

RECOMMENDATIONS

1. Information Handling

The Forum urges the Secretary to request Cabinet Council and OMB approval for the computerization of the ERISA information management system and for the subcontracting of such a project to private firms if studies show the system would be more cost-effective when operated by an outside party. The credibility of the Department's entire effort under Title I depends on its ability to use the information that is filed in the annual reports. If the Department cannot dramatically improve existing information handling, it will continue to be impossible to use all of the information supplied by the public at considerable cost. This recommendation accordingly is given the highest priority by the Forum.

> ERISA imposes detailed requirements on plan sponsors to file annual reports, to prepare plan descriptions and to file and distribute summary plan descriptions. The Forum heard substantial testimony which indicated that the information contained in these filings is not being effectively managed or utilized. The sheer volume of filings -- over 800,000 annual reports per year -- makes

the addition of personnel seem futile. Indeed, this is an area where digital techniques and computers can be of enormous significance. Thus, OPWBP is proceeding at the present time on a pilot project to demonstrate the feasibility of the electronic submission of ERISA data. Over 1000 plans are participating in the pilot, which will be evaluated by the first calendar quarter of 1985.

The information contained in the annual reports is essential to the work of OPWBP. Good and timely information is the single most important means to carry out several of the agency's statutory responsibilities: policy, enforcement and public information. An electronic data base would also improve substantially the functioning of the agency's quasi-judicial responsibilities. Such a data base containing information now variously filed with the Internal Revenue Service (IRS), Pension Benefit Guaranty Corporation (PBGC) and the Social Security Administration (SSA) would result in increased efficiency and cost savings for those agencies as well.

2. Enforcement

The Forum recommends that the Secretary extend to OPWBP the necessary hiring authority to permit the hiring of lawyers in the pension program at the investigative level. Litigation responsibility would remain in the Solicitor's Office, and existing collective bargaining agreements would be observed.

In considering the Department of Labor's performance with respect to ERISA, the Forum has been struck by the fact that ERISA is totally unlike any other law entrusted to the Department. Not only is the law itself highly technical and complex, but it directly impacts on numerous industries, including securities, insurance, investment banking, real estate, etc., which have traditionally not been within the sphere of responsibility of DOL. Additionally, in both the regulatory and enforcement areas, close coordination with other federal agencies, such as the Internal Revenue Service, the Department of Justice, Comptroller of the Currency, and Securities and Exchange Commission, distinguishes the administration of ERISA from that of other laws enforced by the Department.

In the enforcement area, ERISA investigations require detailed knowledge not only of the complex law itself, but also of the operation of the banking, real estate and securities industries and the investment instruments handled by those industries. In addition, banks, investment advisors, and brokerage firms are integrally involved in employee benefit plans. Agencies such as the SEC which undertake complex investigations similar to those required by ERISA have attorneys conduct the investigations and then handle the litigation resulting from their investigative efforts.

Individual Forum members are aware of ERISA investigations which have taken years to complete only to be referred back to the investigator by the Solicitor because the evidence was legally deficient. On other occasions, the litigation discovery process unnecessarily duplicated most of the steps taken during the investigation because the investigation did not obtain the information in legally usable form.

Congress has long recognized that those areas requiring the special expertise of attorneys could not be properly staffed through the normal personnel practices of government. As a result, a special category of hiring authority was created to apply to employment situations not conducive to normal government hiring policies. The primary occupants of these positions in the Federal government are attorneys.

Granting OPWBP the authority to hire lawyers as investigators would permit the Department to obtain the expertise it needs to handle the complexity of ERISA. Such a move would recognize the fact that ERISA is more akin to the laws enforced by agencies such as the SEC (which has the necessary hiring authority) than to the other programs administered by the Department.

3. Rule-Making and Exemption-Granting

The Forum recommends that the Department of Labor explore the concept of a self-regulatory organization (SRO). As the first step in this research, a notice will be published in the Federal Register soliciting comments on the ways in which such an organization might be involved in the prohibited transaction exemption process.

ERISA confers massive responsibility on DOL with respect to regulation of the investment of funds by plan fiduciaries. The law defines very strictly "interested parties" and prohibits their involvement in certain investments. The amount of money subject to ERISA (50% of total NYSE underwritings in 1983, for example) and the dynamic growth of new financial instruments guarantees continuing pressure on DOL for timely issuances of rulings. OPWBP has made a conscious decision with respect to its sparse personnel resources to continue to stress the quality of output despite a continuously rising number of exemption applications received. The Forum heard much testimony on this subject. While the Department's work is respected for its professionalism, the delays are not compatible with the need in the "market place" for rapid financing. There is some evidence that financiers simply avoid ERISA funds as sources of money because of the perceived bureaucratic problems. There is too much money subject to ERISA ($900 thousand million - 25% of NYSE equity) to permit this condition to continue. Limiting timely investment possibilities of ERISA-covered funds will potentially damage their rate of return and, accordingly, the benefits to plan participants.

The Federal Register notice is intended to generate comments on several aspects of the SRO concept, including:

- How the SRO might be organized and financed, and whether existing organizations might play a role in its initial formulation.
- What costs and benefits would be associated with an SRO.

- How timing, composition and planning for an SRO should be structured.

4. Office of Pension Statistics

The Forum recommends that the Secretary create an Office of Pension Statistics within the Office which administers Title I so as to enable the Secretary, as the principal policymaker on retirement income within the Executive Branch, to understand and anticipate developments as they affect pension policy and to make appropriate reports, recommendations and policy initiatives to the Legislative and Executive branches.

Section 513(a)(2) of ERISA authorizes and directs the Secretary of Labor to collect and analyze data relating to employee benefit plans and to report the findings to Congress and to the President. To fulfill this responsibility, the Forum concludes that a central source of statistical information should be established within the Department. The Office of Pension Statistics would rely on the information contained in the electronic data base.

5. OPWBP Culture

The Forum concludes that the requirements for administering Title I of ERISA necessitate a professional culture within OPWBP, and that accordingly the Secretary, whose capacity to organize is not restricted by ERISA, should take certain organizational steps (which are not suggested as being all-inclusive):

A. Rename OPWBP the PENSION & BENEFITS COMMISSION ("PBC"). The objective is to distinguish the PBC from other DOL agencies and to associate with the professionalism connoted by the Securities and Exchange Commission.

B. Designate the principal officer of the PBC as the Commissioner with the rank of Assistant Secretary and provide for the appointment by the Secretary of an Assistant Commissioner. The responsibilities of the executive office of the Commission require two political appointees: one to act as the chief executive officer and the other to have contact with Congressional committees, Executive Branch agencies and private sector groups. The chief operating officer of the PBC should have the title of Administrator and should be a career employee. Continue the practice of having the principal officer of PBC report directly to the Secretary.

C. Designate PBC as a separate entity for budgetary purposes.

6. Public Outreach and Assistance

The Forum urges the Secretary to devote resources for public outreach and assistance. The Forum believes that such a policy helps to protect beneficiaries, foster an attitude of voluntary compliance, and facilitate and make more effective the enforcement program.

> In a limited way, OPWBP has devoted resources to public assistance as a kind of "preventive maintenance" in the belief that helping the public reduces the cost of enforcement. This practice has been challenged in the past. It is the belief of the Forum that ERISA enforcement is facilitated by efforts to reach out to the public in such ways as explaining the operation of the law, assisting in the preparation of returns, and being available to answer technical questions. If the appropriateness of allocating resources to an outreach effort under ERISA continues to be questioned, the Forum urges the Secretary to propose legislation specifically authorizing such an activity.

7. Regulatory requirements

The Forum devoted a great deal of time to considering problems that can be grouped together under the category of regulatory requirements. In lieu of any proposal for statutory change, the Forum submits the following three recommendations to ameliorate the problem of regulatory requirements:

A. In lieu of repeal of §406(or any part thereof), the Forum would urge the Secretary to allocate resources and place priority on the expanded use of class exemptions under §408.

B. The Forum believes that if a good faith effort to evaluate information requirements (the Summary Annual Report, the Annual Report, the individual benefits statement, and other reporting requirements) is made by Executive Branch agencies, Congress would be willing to consider agency recommendations to revise the formats. Notwithstanding earlier studies, it is felt that agency commitment to assuring that beneficiaries receive appropriate information could induce Congressional committees to reconsider the reasonability of present requirements.

C. In evaluating the reporting and disclosure requirements, the Forum urges the Executive Branch agencies to recognize the unique problems of small business in complying with those requirements, and, so far as permitted by law, to make special provisions to ameliorate the burden on small business of such requirements.

POLICY

1. Presidential Task Force

Certain members of the Forum recommend that a Presidential Task Force be designated to study the interrelationship of pension equity and pension cost to both employers and taxpayers. Such a Task Force should be bipartisan and representative, and have a clearly defined scope of work. There is a serious unreality underlying much discussion about retirement income policies, specifically that this country can afford to support all good ideas. There must be a framework within which decisions can be made and priorities established.

> The study should contain specific recommendations about how to make the retirement system equitable without incurring costs that jeopardize the balance of the system. It is suggested that the President organize the Task Force through the Secretary of Labor with input from the IRS, PBGC and SSA.

2. National Retirement Income Policy

With the acknowledgment that national pension policy should not be construed to dictate individual pension decisions, certain Forum members recommend that Congress consider formulating an express National Retirement Income Policy; and that the policy be explicitly considered when making legislative and administrative decisions regarding the three components of retirement income: social security, employer retirement plans (ERISA) and savings.

> The Forum heard testimony from several witnesses about the need for central policy leadership in the retirement income area and has determined that such a broad-based policy directive should come from the Congress.

3. Single Agency

Certain Forum participants endorse H.R. 3339, the bill introduced by Representatives John Erlenborn and William Clay, to consolidate the responsibility for carrying out the provisions of ERISA into a newly established single agency.

The agency, the Employee Benefit Administration (EBA), would be headed by a three-member Board of Directors consisting of a liaison officer from both the Labor and Treasury Departments and the Executive Director of the EBA who would serve as Chairman. The PBGC would retain its current corporate status within the EBA, and the PBGC's Board of Directors would be identical to that of the EBA.

Those participants believe that a single agency for ERISA administration would avoid duplication and inconsistencies frequently experienced under the current system.

4. Relationships with Other Executive Branch ERISA and Benefits Agencies.

Some Forum members recommend that the Secretary request the President to form an Interagency Employee Benefits Council to coordinate pension and welfare benefits information and activities among the different agencies.

Executive Order #12262, dated January 7, 1981, established an Interagency Employee Benefits Council under the leadership of the Secretary of Labor. The Council was to include, among others, the Departments of

Treasury, Justice, Commerce, and Health and Human Services, and a permanent secretariat to be provided by the Department of Labor. The Council would have had coordinating responsibilities with respect to information, inconsistencies and the development of short- and long-term policies as they affect the relationship among the agencies. The Order was not actively effective because it was signed in the last days of the Carter Administration and was repealed in 1982.

During the last four years, interagency coordination has been informal. Crises that have arisen have been handled by the Pension Policy Working Group of the Cabinet Council of Economic Affairs. A permanent Interagency Employee Benefits Council would have the ability to deal with issues before they become crises. It would also work in conjunction with any future single agency for ERISA administration to help achieve coordination with the many agencies which would not be included in the single agency.

ROBERT J DOLE KANS, CHAIRMAN

BOB PACKWOOD ORG
WILLIAM V ROTH JR DEL
JOHN C DANFORTH MO
JOHN H CHAFEE R
JOHN HEINZ PA
MALCOLM WALLOP WYO
VID DURENBERGER MINN
AM L ARMSTRONG COLO
D SYMMS IDAHO
E GRASSLEY IOWA

RUSSELL B LONG LA
LLOYD BENTSEN TEX
SPARK M MATSUNAGA HAWAII
DANIEL PATRICK MOYNIHAN N Y
MAX BAUCUS MONT
DAVID L BOREN OKLA
BILL BRADLEY N J
GEORGE J MITCHELL MAINE
DAVID PRYOR ARK

RODERICK A DEARMENT CHIEF COUNSEL AND STAFF DIRECTOR
MICHAEL STERN MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

December 18, 1984

Mr. Robert Monks
The National Pension Forum
Room S4516
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Dear Bob:

First, congratulations on a job well done as the Administrator of the Office of Pension and Welfare Plans at the Department of Labor for this past year. I was sorry to hear that you will be leaving that position as of the first of the year.

Second, I would like to compliment you on your important leadership role in the National Pension Forum. Although I was unable to personally attend the sessions, it appears that consensus has been reached on many recommendations which would improve the administration of Title I of ERISA by the Department of Labor.

I am in basic agreement with the suggestions contained in the first part of the Pension Forum recommendations. Electronic filing would certainly improve the ability of the Department to utilize the enormous amount of information now being submitted to the agency. The other suggestions appear to offer similar improvements in the efficient administration of the pension law, and in general I support them.

I am concerned, however, that any proposed changes not result in large increases in the agency's budget and also that any involvement of the private sector in the granting of exemptions be done very carefully. The Department must still bear the ultimate responsibility for protecting the assets of the pension plans for the participants and beneficiaries, and this responsibility can not be delegated. The Department's role is not ultimately to facilitate access to ERISA funds in the marketplace, but rather to protect the interests of plan participants and beneficiaries.

The second portion of the recommendations contains several suggestions about which I have serious doubts. For instance, I am very doubtful that a single agency to administer ERISA is appropriate, given the necessary intertwining of the pension law with the rest of the tax code. The Treasury Department and the Internal Revenue Service will undoubtedly have to be involved so long as the incentives for establishing pension plans remain in the tax code.

Thank you for including me in the Pension Forum. I wish you continued success in the private sector.

Sincerely,

John H. Chafee
United States Senator

JHC/fvb

ROD CHANDLER
8TH DISTRICT, WASHINGTON

COMMITTEES
SCIENCE AND TECHNOLOGY
HOUSE ADMINISTRATION

Congress of the United States
House of Representatives
Washington, D.C. 20515

316 CANNON BUILDING
WASHINGTON, D.C. 20515
(202) 225-7761

DISTRICT OFFICES

3350 161ST AVENUE, S.E.
BELLEVUE, WASHINGTON 98008
(206) 442-0116

1025 S. 320TH
FEDERAL WAY, WASHINGTON 98003
(206) 593-6271

December 14, 1984

Mr. Robert A.G. Monks
Office of Pension and Welfare Benefit Programs
U.S. Department of Labor
Washington, D.C. 20210

Dear Bob:

I received your December 6 communication and in response would like to associate myself with the final recommendations of the National Pension Forum.

It has been a pleasure to work with you over the past several months. I am sorry that you will be leaving your position as Administrator of the Pension and Welfare Benefit Programs. Your leadership and friendship will be missed.

Sincerely,

ROD CHANDLER
Member of Congress

RC/kg

INDIVIDUAL VIEWS OF CERTAIN MEMBERS OF THE NATIONAL PENSION FORUM

In general, we support the recommendations of the National Pension Forum. We believe that the establishment of the Forum to discuss issues of concern to the employee benefit community provided a welcome opportunity to establish a dialogue among members of the Advisory Council, the Executive Branch, and the Congress and we believe it served a constructive purpose.

We have some concerns, however, that the report may not adequately reflect the priorities which the members of the Forum expressed with respect to those recommendations. In addition, the document does not provide enough insight into the reasons why the Forum made certain of the recommendations it did. Finally, we believe the document does not sufficiently emphasize the strong consensus which existed among Forum members that, in the exercise of its Title I responsibilitities, the Department measure any proposal for change against its primary mission: to protect the interests of employee benefit plan participants and beneficiaries.

Both in the public sessions of the Forum and its work sessions, near unanimity existed among Forum members on the need for the development of a national policy to assure adequate retirement income for American workers and their dependents. Yet that recommendation, which was also strongly endorsed by practically every private sector witness at the September public session, is buried in the back of the report. The reason given for that placement is that such a recommendation was beyond the scope of the Secretary of Labor's original mandate for the Forum: namely, "matters concerned with Departmental organization."

We do not understand how any recommendation could be more critical to the Secretary's fulfillment of his Title I responsiblities. How would one evaluate the Secretary's performance of his duties and stewardship of the pension program, if not against the backdrop of whether his actions were consistent with and served to advance our national retirement income policy?

The lack of policy benchmarks necessary to evaluate new regulatory and legislative proposals leads to inconsistency and confusion within the Congress and the employee benefits community at large as to what the law is and what, if anything, should be done to improve it.

For instance, the composition of our workforce is rapidly changing and women now make up almost half of the workers in this country. Many pension plans were established based on what are now obsolete and incorrect assumptions about the roles of men and women in our society.

It seems critical to rethink the assumptions upon which the private pension system is structured in order to more adequately and equitably reflect the needs of all workers. Yet without a national retirement income policy, proposals for change are difficult to evaluate.

The members of the Forum see this as a serious problem which needs to be solved before the Secretary can make any rational choices with respect to the organization of his Title I responsiblities and the allocation of exceedingly scarce Department resources.

In our opinion, the recommendation that a national retirement income policy be developed and articulated falls within the scope of the Secretary's mandate to the Forum. Moreover, we believe that the consensus within Forum members is that this recommendation be given the highest priority.

With respect to the findings and recommendations described in the report, we believe that some further elaboration is necessary in a few areas.

First, we strongly endorse the recommendation that the information collection and handling process be computerized. The development of a better information handling system is quite important, and within the group of recommendations which the Secretary may implement without legislative change, we agree this recommendation deserves the highest priority.

The electronic filing of data is merely the means to the dual ends of a more efficient and effective enforcement program and a data base capable of making available to policymakers in a timely fashion the information critical to their evaluation of legislative and regulatory proposals for change. In that context, we urge the Administration (and particularly the Office of Management and Budget) to make a long-term commitment to establish as a budget priority the provision of adequate Department resources to make the Forum's recommendation a reality.

We are concerned about the part of the information handling recommendation which appears to endorse the idea of subcontracting out such a project "if studies show the system would be more cost-effective when operated by an outside party." We could not support such a concept if displacing existing Labor Department workers currently performing those functions would result.

Second, we agree that a strong enforcement program is critical to the Secretary's ability to fulfull his statutory obligations to participants and beneficiaries. The Department must establish a reasonable and balanced enforcement structure which is not susceptible to political manipulation. Realistic goals must be set and an objective way to measure the attainment of those goals must be established. In short, the Department must be accountable, not just to the Congress but also to the participants and beneficiaries who depend on its efforts to make sure plan sponsors are complying with the law.

Extending to OPWBP the necessary hiring authority to permit the hiring of lawyer/investigators is important but only one way to improve the Department's enforcement ability. It is not a panacea for the Department's failure to have a strong, balanced enforcement program, even though the Forum report might give the impression that it will be.

Third, we do not believe it to be the mission of the Labor Department to assure access to the pools of capital subject to ERISA. We agree that in some cases in which Department action is necessary to approve transactions between plans and parties-in-interests, the lead time necessary to grant such exemptions is far too long.

But a substantial amount of capital subject to ERISA is already available through transactions which do not involve parties-in-interest and, therefore, do not require Labor Department action as a precondition to the transaction. When the Labor Department is asked to approve a transaction which is prohibited under ERISA, its statutory responsiblity is clear. The Secretary must find that such an exemption is:

1. administratively feasible,

2. in the interests of the plan and of its participants and beneficiaries, and

3. protective of the rights of participants and beneficiaries of such plan. (see Section 408(a) of ERISA)

Nowhere in the statute can be found a mandate to the Secretary to consider the need to provide access to capital for the U.S. economy via the transaction in question. While we are certainly aware of the need for capital and that pension funds are probably the only new source of capital for most sectors of the economy, we are concerned that the report places undue emphasis on this factor at the expense of the statutory requirements.

The most controversial of all the Forum recommendations and the one in which little consensus was possible is in the area of the establishment of a self-regulatory organization (SRO). When the Department staff first raised this issue at the November working session, there was sharp disagreement among Forum members as to whether this idea was one worthy of pursuing. To the extent there was any consensus at all around this issue it focused on the Forum's inability to assess the proposal because the members lacked information about it.

As a compromise between members who simply thought that the use of a SRO was a bad idea and were willing to vote to reject it immediately and those who thought the idea might have some merit if it were fleshed out and researched more, the Forum agreed that a notice be put in the Federal Register soliciting comments on the idea in general as well as ways in which the SRO might be utilized in the exemption process.

Although the discussion of this issue in the Forum report is a significant improvement over the language of earlier drafts, it still fails to reflect the clear concern of the members of the Forum that individuals and/or groups who oppose the basic concept of a SRO have an opportunity to present that view. Neither the report itself nor the draft Federal Register notice states that comments will be solicited on whether or not the use of the SRO is a good idea. In our view, that is essential to reflect the true consensus of Forum members on this recommendation.

In addition, several of the Forum members have questioned the legal authority of the Secretary to establish a SRO along the lines described in the draft Federal Register notice, absent clear statutory authority for the Secretary's action. We believe that the draft notice should be revised to solicit comments on the issue of the Secretary's authority to utilize a SRO in the exemption process.

Fourth, we strongly endorse the Forum recommendations in the area of public outreach and assistance. We agree that devoting resources to this type of public assistance is an integral part of the enforcement effort and that allocating resources to this type of a program will in the long run reduce the Department's enforcement costs.

Fifth, we are concerned that the Forum report may not adequately summarize the consensus of Forum members in the area of regulatory requirements. The overwhelming number of Forum members strongly opposed the repeal of section 406 of ERISA; therefore, we believe the language "in lieu of repeal of section 406 (or any part thereof)" is misleading. Repeal of section 406 was simply not an option that was considered by most Forum members.

In addition, it probably would not be productive for the Executive Branch to focus its attention merely on the evaluation of the information requirements under ERISA. An internal task force on paperwork created under former PWBP Administrator Jeffrey N. Clayton has already done that job. Instead of continuing to recommend repeal of certain statutorily mandated items of disclosure (for example, the Summary Annual Report (SAR)) because the Department may believe the items disclosed are not useful to participants and beneficiaries, the Department ought to be determining what items could be included in a SAR which would be useful.

Sixth, and last, we are pleased that the Forum has endorsed the idea of a single independent agency to administer ERISA and the establishment of a permanent Interagency Employee Benefits Council. In discussing these proposals, consensus emerged that the orderly development of retirement income policy can only be achieved if a mechanism were established to permit continual monitoring of regulatory and administrative issues. There was agreement (although not unanimity) that a system in which policy is developed only around a particular issue ("crisis") is not the way we believe policy should be developed. We need to formalize the policymaking structure so that long term policy development is the focus. The continuation of a structure in which policymaking is reactive rather than ongoing and developmental was not considered desirable by most Forum members.

In summary, we generally support the findings and recommendations of the National Pension Forum with the exceptions noted above. We believe its establishment was a positive step and reflects the importance of maintaining a continuing bipartisan dialogue on employee benefit issues.

Representative William L. Clay

Representative Edward R. Roybal

Senator Howard M. Metzenbaum

Representative Mary Rose Oakar

Representative Sala Burton

ROBERT J DOLE KANS CHAIRMAN

BOB PACKWOOD OREG
WILLIAM V ROTH JR DEL
JOHN C DANFORTH MO
JOHN H CHAFEE RI
JOHN HEINZ PA
MALCOLM WALLOP WYO
DAVID DURENBERGER MINN
WILLIAM L ARMSTRONG COLO
STEVEN D SYMMS IDAHO
CHARLES E GRASSLEY IOWA

RUSSELL B LONG LA
LLOYD BENTSEN TEX
SPARK M MATSUNAGA HAWAII
DANIEL PATRICK MOYNIHAN N Y
MAX BAUCUS MONT
DAVID L BOREN OKLA
BILL BRADLEY N J
GEORGE J MITCHELL MAINE
DAVID PRYOR ARK

RODERICK A DeARMENT CHIEF COUNSEL AND STAFF DIRECTOR
MICHAEL STERN MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

December 7, 1984

Mr. Robert Monks
The National Pension Forum
Room S4516
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Dear Mr. Monks:

I continue strongly to support the stated purpose of The National Pension Forum--to propose recommendations to improve the Labor Department's ability to fulfill its obligations under ERISA--and believe that the Forum's proposed recommendations discussing Departmental organization will, for the most part, assist the efforts of the Labor Department in this regard.

I agree with the Forum that more efficient mechanisms for handling and using the vast amount of pension information that the Labor Department receives are needed. I also believe that measures must be taken to allow more prompt responses to the public's need for assistance and information regarding complianc with ERISA's complex requirements.

I do have some concerns about the effect of any recommendation that would significantly expand the size of the Labor Department agencies in order to accomplish the goals discussed above. Moreover, I particularly would want to ensure that in the area of rule making and exemption-granting, any participation by the private sector be reviewed very carefully to prevent any abrogation of the Labor Department's important responsibility to make sure that pension funds are invested prudently. While additional private sector help may assist in a more efficient review process, care must be taken that the Labor Department review does not inadvertently suffer in quality.

Finally, I cannot endorse at this time the policy recommendations espoused by some members of the Forum. In particular, the suggestion that a single agency be created to administer national pension policy causes practical and political concerns. However, I believe that the issues of the development of a national retirement policy and the coordination of government agencies which influence retirement policy deserve serious attention. I am certain that the efforts of the Forum to examine and air these issues will provide an important tool for future consideration.

I would appreciate your including these views in your final report.

Sincerely,

BOB DOLE
Chairman

JOHN N. ERLENBORN
13TH DISTRICT, ILLINOIS

COMMITTEES
GOVERNMENT OPERATIONS
EDUCATION AND LABOR
(RANKING REPUBLICAN MEMBER)

Congress of the United States
House of Representatives
Washington, D.C. 20515

WASHINGTON OFFICE
RAYBURN HOUSE OFFICE BUILDING
PHONE: (202) 225-3515

CONGRESSIONAL DISTRICT OFFICE
911 NORTH ELM STREET
HINSDALE, ILLINOIS 60521
PHONE: (312) [illegible]

December 13, 1984

Mr. Robert A.G. Monks
Adminstrator
Office of Pension and Welfare Programs
Department of Labor
Room S4516
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Dear Bob:

This is to let you know that I subscribe to the Final Recommendations of the National Pension Forum as distributed to participants on December 6, 1984, by Ann Colgrove. In particular, I wish to be associated with the Policy Statement.

When the master copy of the final report is available, please send it to Seyfarth, Shaw, Fairweather & Geraldson at 1111 - 19th Street, N.W., Washington, D.C. 20036, for my signature.

Let me take this opportunity to commend you and Secretary Donovan for convening the Forum. I believe it was an instructive and constructive project.

With best wishes to you personally for your new ventures, the Holidays, and the New Year, I am

Sincerely yours,

John N. Erlenborn, M.C.
2206 House Office Building

JNE/jay

Congress of the United States
Washington, D.C. 20515

December 14, 1984

Mr. Robert Monks
Administrator
Office of Pension and Welfare Benefit Programs
U.S. Department of Labor
Washington, D.C. 20210

Dear Mr. Monks:

We believe the National Pension Forum has been a worthwhile undertaking and has served its purpose well in calling attention to the issues of concern in the administration of Title I of ERISA, on the tenth anniversary of its enactment.

The Forum has brought together a diverse group of individuals from the employee benefits community. While agreement on the issues has been in many respects elusive, the discussion has been healthy and we are generally in support of the seven recommendations in the Forum's final report. Although we each have concerns about some details of the recommendations and the manner in which some of the recommendations are presented, we are generally supportive of the first part of the report and hope the guidelines set forth will be helpful to the Secretary in improving the Department's ability to fulfill its responsibility under Title I.

In particular, because of our concern that protection of the interests of pension plan participants and beneficiaries must be the first priority of the Department of Labor, we believe the Secretary should explore the idea of a self-regulatory organization with great caution. Since the assets of funds subject to ERISA represent a significant and growing concentration of capital in our economy, we believe the Secretary should fully investigate the many potential risks as well as the possible benefits inherent in the concept of a self-regulatory organization.

We appreciate the fact that the second part of the National Pension Forum final report is outside the scope of the Forum's mission and is intended to represent only the views of the individuals who chose to associate themselves with it, as the recommendations are not the product of the Forum as a whole.

We do wish to express our serious reservations about the merits of recommending a newly established single agency to consolidate the responsibility (shared currently by the Department of Treasury, Labor and the Pension Benefit Guaranty Corporation) for carrying out the provisions of ERISA and we do not believe it is appropriate to say the Forum endorses the idea. The proposal is premised on the view that such a newly established agency would streamline ERISA administration by "avoiding duplication and inconsistencies frequently experienced under the current system."

We are of the opinion that Reorganization Plan No. 4 of 1978 has successfully addressed important ERISA jurisdictional overlap and duplication and has met the objective of reducing ERISA's administrative burden on employers and plan administrators. To the best of our knowledge, agency coordination and cooperation are working well, and the benefits of this successful coordination redound to the private sector.

We suspect that the creation of a proposed single agency would itself foster the duplication and administrative complexity some argue it is intended to eradicate. For example, the new "single" agency proposal would not end dual administrative jurisdiction with respect to pension plan qualification because several of the plan qualification rules under ERISA incorporate tax rules which apply for nonpension purposes (such as determinations as to whether business entities are under common control). We would be extremely concerned by any proposal that would shift significant administrative determination responsibilities in this tax benefit area to agencies other than the Department of Treasury and the Internal Revenue Service.

Furthermore, it is not at all unreasonable to expect that the transition to a new single agency would take many years, involve a further series of Executive Order reorganization plans, disrupt plan administration because of changes in policy and personnel, add another layer of bureaucracy (significantly, at lower than a cabinet level), and generally increase the number of government employees at some cost to taxpayers.

In closing, private pensions are an extremely important component of retirement security for millions of American workers and their dependents. We believe the National Pension Forum has served a very constructive purpose and hope there will be continuing efforts to meet the many challenges which remain in ensuring the protection and provision of adequate income for retired workers.

Sincerely,

Barbara B. Kennelly J J Pickle Marty Russo

BARBARA B. KENNELLY, M.C. J. J. PICKLE, M.C. MARTY RUSSO, M.C.

DAN QUAYLE INDIANA, CHAIRMAN
WENDELL H FORD KENTUCKY COCHAIRMAN

CHARLES McC MATHIAS MD
JAKE GARN UT
MALCOLM WALLOP WY
BOB KASTEN WI
WARREN B RUDMAN NH

RUSSELL B LONG LA
JOHN MELCHER MT
J BENNETT JOHNSTON LA
SPARK M MATSUNAGA HI
ALAN J DIXON IL

United States Senate
TEMPORARY SELECT COMMITTEE TO
STUDY THE SENATE COMMITTEE SYSTEM
WASHINGTON, DC 20510

January 4, 1985

Ann Colgrove, Director
National Pension Forum
Room S4516
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Dear Ms. Colgrove:

Thank you for inviting me to endorse the National Pension Forum's recommendations for the improved administration of Title I of ERISA. As you know, this is an area in which I am deeply interested and which I have followed closely. I commend the Forum's thorough and cogent analysis of the administrative difficulties the Department of Labor has experienced in handling ERISA and the proposed solutions to these difficulties.

However, I am reluctant to formally endorse the Forum's proposals without a complete understanding of the budgetary implications of these proposals.

I am convinced of the value of the National Pension Forum's activities and I appreciate this opportunity to comment on the Forum's ideas. Thank you for your consideration.

Sincerely,

Dan Quayle
U.S. Senator

DQ:mcb

EDWARD R. ROYBAL, CALIF.
CHAIRMAN

CLAUDE PEPPER, FLA.
MARIO BIAGGI, N.Y.
IKE ANDREWS, N.C.
DON BONKER, WASH.
THOMAS J. DOWNEY, N.Y.
JAMES J. FLORIO, N.J.
HAROLD E. FORD, TENN.
WILLIAM J. HUGHES, N.J.
MARILYN LLOYD BOUQUARD, TENN.
STAN LUNDINE, N.Y.
MARY ROSE OAKAR, OHIO
THOMAS A. LUKEN, OHIO
GERALDINE A. FERRARO, N.Y.
BEVERLY B. BYRON, MD.
WILLIAM R. RATCHFORD, CONN.
DAN MICA, FLA.
HENRY A. WAXMAN, CALIF.
MIKE SYNAR, OKLA.
BUTLER DERRICK, S.C.
BRUCE F. VENTO, MINN.
BARNEY FRANK, MASS.
TOM LANTOS, CALIF.
RON WYDEN, OREG.
DONALD JOSEPH ALBOSTA, MICH.
GEO. W. CROCKETT, JR., MICH.
WILLIAM HILL BONER, TENN.
IKE SKELTON, MO.
DENNIS M. HERTEL, MICH.
ROBERT A. BORSKI, PA.
FREDERICK C. (RICK) BOUCHER, VA.
BEN ERDREICH, ALA.
BUDDY MacKAY, FLA.
HARRY M. REID, NEV.
NORMAN SISISKY, VA.
TOM VANDERGRIFF, TEX.
ROBERT E. WISE, JR., W. VA.
BILL RICHARDSON, N. MEX.

JORGE J. LAMBRINOS
STAFF DIRECTOR

U.S. House of Representatives
Select Committee on Aging
Washington, D.C. 20515
Telephone (202) 226-3375

MATTHEW J. RINALDO, N.J.
RANKING MINORITY MEMBER

JOHN PAUL HAMMERSCHMIDT, ARK.
RALPH REGULA, OHIO
NORMAN D. SHUMWAY, CALIF.
OLYMPIA J. SNOWE, MAINE
JAMES M. JEFFORDS, VT.
THOMAS J. TAUKE, IOWA
JUDD GREGG, N.H.
GEORGE C. WORTLEY, N.Y.
HAL DAUB, NEBR.
LARRY E. CRAIG, IDAHO
PAT ROBERTS, KANS.
COOPER EVANS, IOWA
JIM COURTER, N.J.
LYLE WILLIAMS, OHIO
CLAUDINE SCHNEIDER, R.I.
THOMAS J. RIDGE, PA.
JOHN McCAIN, ARIZ.
MICHAEL BILIRAKIS, FLA.
GEORGE W. GEKAS, PA.
MARK D. SILJANDER, MICH.
CHRISTOPHER H. SMITH, N.J.

PAUL SCHLEGEL
MINORITY STAFF DIRECTOR

December 14, 1984

The Honorable Raymond J. Donovan
Office of the Secretary
U. S. Department of Labor
200 Constitution Ave.
Washington, D. C. 20515

Dear Secretary Donovan:

Pursuant to the final recommendations of the National Pension Forum of the U. S. Department of Labor, I herewith sign and endorse, while expressing certain dissenting views, the recommendations of the National Pension Forum (Forum). I also associate myself with certain individual views separately expressed by other Forum members which are submitted with my signature. First, however, let me indicate my appreciation for your convening of this most important forum to discuss the Department's administration of the Employee Retirement Income Security Act of 1974 (ERISA) on its 10th Anniversary. I believe that the exercise of the Forum in developing issues, discussing policy and the production of consensus in certain critical areas will serve to spur us all to pursue a more coherent and productive pension and welfare benefit policy and to provide for a more secure financial and healthful retirement for all older Americans.

With respect to the specific recommendations of the Forum however, there are certain concerns which I must express a dissenting view on as a matter of policy and, in some instances, as a matter of simple practicality, wisdom and the rule of law.

My greatest reservation with respect to the recommendations of the Forum involve those statements pertaining to the use of a so-called self-regulatory organization (SRO). The statement in which the Forum recommends the Department explore the concept of an SRO suggests an imprimatur among Forum participants which I believe does not exist. The Forum without recommendation suggested that it was appropriate for the Department to explore and obtain public comment on the arrangement and use of an SRO. I must confess serious reservations regarding the statutory authority of the Department to permit the use of such a vehicle under Title I of ERISA. Moreover, the policy underpinning the use of such a vehicle would seem to conflict with the inherent concern regarding conflicts of interest evidenced by the prohibited transaction provisions of ERISA and the Code. The analogies drawn in the proposed Federal Register notice to the National Association of Securities Dealers (NASD) and Financial Accounting Standards Board (FASB) are inapposite because these are organizations concerned with the setting of standards for their profession or for broker-dealers. Nor do these organizations perform functions which are statutorily reserved to be performed by a federal agency. While some consideration to such a concept is merited, perhaps in the vein of an educational or conciliatory function for an SRO, the use of such a vehicle to deliberate and pass on applications for exemption would seem to exceed any statutory basis. I reiterate my earlier suggestion that additional staff resources, training and other supportive services be provided to handle the existing workload of exemption applications. Moreover, I strongly urge that responsible departmental officials must be admonished and constrained to make final decisions regarding exemption applications within a reasonable period of time.

I support the Forum's recognition that the most important responsibility of the Department of Labor is to protect the interests of plan participants and beneficiaries under employee benefit plans in the private sector. The Department's recognition of this responsibility under ERISA cannot be overemphasized. The Department should make strenuous efforts to identify and correct new manifestations of imprudent and improper actions by employers and plan fiduciaries which jeopardize the benefit security of a growing number of plan participants and beneficiaries. These actions, thinly veiled as exercises of an employer's prerogative, result in significant reductions in needed benefits to workers under both pension and welfare benefit plans. Termination of overfunded pension plans and recapture of excess assets, termination and reduction of retiree health and hospitalization benefits, contributions of employer stock, manipulation of "appropriate" interest rate assumptions for funding, use of ESOPs as defensive and offensive takeover vehicles and for the entrenchment of corporate management and other practices which directly inure to the benefit of plan sponsors are either tolerated by the Department or are, in some instances, sanctioned as Administration policy. These practices must be reexamined in light of the law and policy of ERISA and the Code and new efforts undertaken to assure the sanctity of the pension and welfare benefit promise.

With respect to the use of an electronic management information system by the Department, I believe that the use of such a system will greatly enhance the Department's ability to receive, analyze and to produce statistical data from the various annual report forms which are required to be filed by plan sponsors. Such a system should greatly reduce the data processing time needed to analyze this information.

Although I concur that a strong enforcement program is critical to the administration of ERISA, and while I have expressed reservations regarding the efficacy, breath and lack of objectives of this program, I believe that merely indicating that the present enforcement program is "unacceptable" does not give appropriate recognition to the scope, nature and severity of the problems experienced under this program. What is needed is a thorough reexamination and redefinition of the goals and objectives of this program and an increase in the training of staff and professionalism needed to accomplish sophisticated investigations and comprehensive monitoring of plan activity. I support the Forum's recommendation that hiring authority for lawyers be extended to the administrative office to enhance their investigative and other program efforts.

While I agree that the rule making and exemption processes of the Department have generally evidenced high quality and thorough deliberation, it is fair to say that the Department has not met its obligation to expeditiously consider and adjudicate exemption applications, particularly class exemptions which have broad impact and may be needed in a timely fashion. I take exception to the statement that the "American economy needs to have access to ERISA funds...". Clearly, the requirement and intent of ERISA is to constrain plan fiduciaries to act for the exclusive benefit and in the best interest of plan participants and beneficiaries. Substantial and frequent transactions in pension plan assets are increasing and will continue to do so. What is needed and what is recognized by the pension and investment communities is that the priority and budget of the Department's pension and welfare benefit program must be increased to meet the needs attendant to individual and class relief from the prohibited transaction provisions of ERISA.

With respect to the Forum's support for public outreach and assistance to plan participants and beneficiaries, I wholly support and recommend that the policy of protecting plan participants and beneficiaries be the singular charge of the Department with respect to the ERISA program. Greater efforts need to be expended by the Department to meet the volume of letters, Congressional inquiries, telephone calls and other inquiries made regarding ERISA and its application to individual plan participants. Such a use of resources will enhance and relieve the enforcement efforts of the Department, provide education and protection to individual plan participants and is consistent with the protective role of the Federal government in the area of pension and welfare benefits security.

I take strong exception with the statement "in lieu of repeal of section 406..." which is contained in the Forum's recommendation on regulatory requirements. I believe that proceduraly, no formal recommendation by a Forum member was made to repeal section 406 of ERISA. While there was sentiment among some Forum members for such a repeal, many Forum members strongly suggested the deletion of this offending language which remains in the final recommendation. It should be noted that the law and policy on prohibited transactions as enunciated in ERISA is incontrovertible and it is my belief that it should remain so. I would again urge an increase in staff and other resources to provide for exemptive relief for individual and class applications to address any inadequacy in the present administration of this program of the Department.

With respect to the Forum recommendation that the Summary Annual Report, the Annual Report, the Individual Benefits Statement, and other reporting requirements be evaluated so that Congress will provide flexibility to revise information formats, I have some specific reservations. I have previously stated my belief that the reporting and disclosure requirements of ERISA perform a valuable and needed function to protect plan participants and beneficiaries. Any reduction in information by the Department in these critical areas must be carefully considered. I believe that the Summary Annual Report would perform a useful function if the Secretary would exercise his authority to require a document which is a full and "fair summary" of the information contained in the full annual report as constrained under section 103(a) (3) (A) of Title I. Thus, a written summarization of information understandable to the average plan participant would be an effective disclosure device. I would also note that the Department has been derelict in its responsibility to issue final regulations on the accrued benefit statement required under sections 105 and 209 of Title I, provisions which have been in effect for nearly ten years. The failure of the Department to prescribe a standardized format for such critical information reflects poorly on the Department's concern for accurate and adequate disclosure of this information to plan participants and submits participants and beneficiaries to practices which may well violate the spirit if not the letter of ERISA's requirements in this area. Revision of forms and disclosure of mandated information is permitted under the strictures of sections 110 for pension plans and 104 (a) (3) for welfare plans. Such authority should continue to be utilized by the Department to addresss those concerns for breath and quality of plan information and disclosure.

I along with other Forum members wholeheartedly endorse the creation of a single employee benefits agency and the promulgation of a national pension and welfare benefits policy. Such a policy would attempt to bring coherence and direction to the disparate federal policies presently impacting on the provision of employee benefits.

I would like to take this opportunity to thank Mr. Robert Monks, Administrator of OPWBP for his efforts in convening and conducting the National Pension Forum. I would like to thank my fellow Forum members for their efforts and insights in attempting to fashion a constructive analysis and dialogue on those issues of importance to the protection of pension and welfare benefit participants and beneficiaries.

Sincerely,

Edward R. Roybal

Edward R. Roybal
Chairman

ERR:eu

COMMENTS ON NATIONAL PENSION FORUM RECOMMENDATIONS
BY
CONGRESSMAN RON WYDEN

December 14, 1984

The retirement income crisis of the past few years has made clear the need for a comprehensive, national retirement policy in this country. In setting up this National Pension Forum, which brought together members of the Executive Branch, Congress and the Advisory Council, Robert A.G. Monks, Administrator of the Office of Pension and Welfare Benefit Programs, has helped further this goal, for which he is to be commended.

In general, I concur with the recommendations of the Forum. In particular, I agree wholeheartedly with the recommendation that the information collection and handling process be computerized. The need for more efficient handling of information coming into the office is clear, and should be given a high priority. I also concur with the need for an enhanced enforcement program to ensure that the rights of participants and beneficiaries are protected. OPWBP's enthusiasm in pursuing this goal, however, should not hinge on whether it is given authority to hire lawyers or investigators to work directly in the office. There are other, equally acceptable, ways of achieving this goal and they should be pursued vigorously whether or not the hiring authority is granted. Finally, I strongly support the recommendation that a single independent agency be established to administer ERISA and that a permanent Interagency Employee Benefits Council be established. These steps should aid in moving us toward a more aggressive approach to setting retirement policy, and away from the largely reactive stance of today.

I do have some concerns about certain aspects of the Forum's report. Fo[illegible]e, I do not feel the final document included a sufficiently strong statement concerning the Forum participants' feeling that the need to protect the interests of employee benefit plan participants and beneficiaries should weigh most heavily in Department of Labor decisions on proposed changes. And although the very establishment of the Forum in my opinion indicated a recognition of the need for development of a rational and comprehensive reirement policy in this country, I do not think the wording of the report adequately reflected the Forum members' strong feelings on this subject. The events of the past few years have made it clear that providing adequate retirement income for Americans is one of the greatest challenges facing us in the years ahead. As such, I believe the report should have placed greater emphasis on this critical goal.

I also continue to have concerns about the establishment of a self-regulatory organization (SRO) to monitor the activities of the Department of Labor. Although I would not completely rule out the possibility that such an organization could prove beneficial, I believe the potential problems are significant enough to warrant very careful analyses and consideration before this proposal is pursued further.

Finally, I am disappointed that the report did not include a discussion of the need for increased pension portability. With the ever-increasing mobility of our workforce, particularly among women, it is critical that we address this issue — and that we do so now. Otherwise, many Americans will continue to be cheated out of a decent retirement income simply because career or other needs necessitated movement between jobs.

In conclusion, with the exceptions noted above, I am generally supportive of the findings and recommendations of the National Pension Forum. Establishing a workable retirement policy in this country will not be easy. By initiating an open dialogue and debate, the National Pension Forum has helped move us further in that direction, and, as such, was a very worthwhile endeavor.

UNITED STATES
FEDERAL SERVICE IMPASSES PANEL
500 C STREET SW • WASHINGTON, D.C. 20424

c/o Local 695
P.O. Box 1726
Studio City, CA 91604

December 15, 1984

MEMORANDUM

TO: NATIONAL PENSION FORUM,
ANN CALGROVE

FROM: ROY M. BREWER

SUBJECT: FINAL RECOMMENDATIONS

This is in reply to your memorandum of December 6th.

FINDINGS

I have no problem with Item 1 and Item 2.

With respect to Item 3, Rule-making and exemption-granting, I do not believe that under the present act it is proper to use the exemption process to determine the validity of an exemption on the basis of its effect on American economy. I think the restrictions are so much a part of the act that this will require Congressional action to set down a clear cut policy as to what investments restrictions can be modified and which cannot.

I envision the exemption-granting policy as being for the purpose of dealing with extraordinary cases and under the present act cannot be evaluated with the objective being the freeing up of funds for the purpose of influencing the American economy. What is needed in my opinion are new rules and not new organizational devices or personnel.

4. Policy. I do not disagree with 4.

5. I do not oppose 5 but I am not sufficiently informed as to the present difference between the autonomy exercised by the Bureau of Labor Statistics and the OPWBP to intelligently decide whether this would or would not be an asset.

RECOMMENDATIONS

I have no objections to Item 1.

I have no objections to Item 2.

Item 3. I have the same objections as stated in Item 3 of the Findings. I do not believe the problem of releasing funds from the pension reserves for the purpose of bolstering the economy is a discretionary matter to be exercised by the Department. I think that this requires broad new policies by Congress.

I agree with Item 4.

5. I do not believe that the changes proposed in 5 will contribute to the solutions of the problems which we are facing today. Energies that might be devoted towards this end can better be expended in other areas.

6. I have no problem with 6.

7A. Here again I object to an attempt to solve the problems, which are inherent in the act, by the granting of broad discretionary powers in an area which deals with matters of such magnitude. I believe that the answer is to further analyse and isolate the problems and then seek Congressional reform.

I do not believe that we can find a single solution to the multiplicity of problems confronting us. I believe that there is a distinct difference between the problem and the solution for each of the three distinct groups, namely, the Single Employer Plan, the Multi Employer Plan and the Health and Welfare Benefit Plan. Before we are going to find solutions, we are going to have to understand the difference between the problems in these three groups and perhaps others. I think this break down should precede any recommendations with respect to any action on the repeal, or modifications of Sections 406 and 408.

I do not disagree with 7B or 7C.

POLICY

In the last paragraph of 1, you refer to "specific recommendations about how to make the retirement system equitable".

Question. Do you consider health and welfare benefits to be a part of a retirement system? I do not really believe that they are. If not, then are you recommending that the Presidential Task Force not deal with the subject of health and welfare benefits? If so, then I think it would be wrong. This same basic question runs through the entire policy statement.

I have no criticism with the rest of the policy statement.

RMB/eh

MANUFACTURERS HANOVER TRUST COMPANY

40 WALL STREET NEW YORK N Y 10015

January 9, 1985

Mr. Robert Monks
Administrator - PWBP
Room - S4516
200 Constitution Ave, NW
Washington, D.C. 20210

Re: Final Recommendations - National Pension Form

Dear Bob:

As I discussed with Ed Lyczek over the telephone, I thought the draft of the final recommendations was an outstanding job. The ability of your troops to wade through the mountain of information generated this year and distill it in a good solid and concise recommendation to the secretary cannot go without recognition.

While I am sure anyone can find specific items that they would change, you certainly have identified the key elements and the path that can be followed in moving forward to make progress.

My congratulations and thanks to you and your staff.

Sincerely,

Charles A. Moran
Senior Vice President

CC: Ms. Ann Colgrove ✓
Director - National Pension Form

8580 3'84

American Federation of Labor and Congress of Industrial Organizations

815 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 637-5000

EXECUTIVE COUNCIL

LANE KIRKLAND PRESIDENT **THOMAS R. DONAHUE** SECRETARY-TREASURER

John H. Lyons
Murray H. Finley
Sol C. Chaikin
Charles H. Pillard
Alvin E. Heaps
John DeConcini
Joyce D. Miller
James E. Hatfield
Vincent R. Sombrotto
Marvin J. Boede
Owen Bieber
Thomas W. Gleason
Albert Shanker
Edward T. Hanley
J. C. Turner
William W. Winpisinger
Wayne E. Glenn
John J. Sweeney
Barbara Hutchinson
Gerald W. McEntee
Patrick J. Campbell
John T. Joyce
Frederick O'Neal
Glenn E. Watts
Angelo Fosco
Kenneth T. Blaylock
William H. Wynn
Robert F. Goss
Frank Drozak
Richard I. Kilroy
William H. Bywater
Kenneth J. Brown
Lynn R. Williams

December 14, 1984

Ms. Ann Colgrove
Office of Pension and Welfare
  Benefit Programs
U.S. Department of Labor
Room S-4516
200 Constitution Avenue, N. W.
Washington, D. C. 20210

Dear Ann:

Per your memorandum of December 6, 1984, I am informing you of my general support for the recommendations of the National Pension Forum with the exceptions set forth below.

Enforcement - A strong and balanced enforcement program is vital to the administration of ERISA. But the program must be impartial and not subject to political influence. The report makes only one recommendation for strengthening the program - that the Secretary of Labor extend to OPWBP the authority to hire lawyers at the investigative level. This will enable the Agency to obtain the expertise essential to deal with ERISA complexities and avoid those situations where investigations which have taken years to complete are referred back to the investigators by the Solicitor because the evidence was legally deficient.

However, in my opinion, the enforcement section does not fully conform to the consensus reached by the Forum. It was my understanding that the lawyers participating in investigations would not be a party to the decision as to the legal sufficiency of the investigative file. This is essential to an objective determination whether to litigate and to avoid having those who are partisans in a investigation influence that decision.

Information Handling - Computerization of the OPWBP information management system is essential to enable the present staff to do their job. Timely and accurate information is vital to the effective administration of ERISA and is crucial to the intelligent evaluation of legislative and regulatory proposals. It deserves high priority.

One aspect of this recommendation concerns me. The report should state clearly that the computerization project will not result in the displacement of present staff. The Administrator said this during Forum discussions but it is only implied in the report. I would not support this proposal if the result were to displace workers currently performing these kinds of functions.

Rule - Making and Exemption - Granting - . The Report accurately reflects the Forum consensus not to take a position on the self-regulatory organization (SRO) but rather to study the concept further by publishing a notice in the federal register soliciting comments on it.

However, the report does not reflect the views of Forum members who oppose the basic concept since neither the report or the notice in the Federal Register states that comments will be solicited as to whether the basic concept has any merit. In addition, the report and Federal Register notice both apparently assume that authority now exists which would enable the OPWBP to use this kind of a private sector organization. Some legal authorities dispute this since similar organizations such as the National Association of Securities Dealers (NASD) have been established pursuant to specific authority in a law. ERISA has no provision of this kind. Thus, the Federal Register notice should solicit comments on whether the Secretary of Labor has legal authority to create such an organization.

Overregulation - Paragraph A begins with the phrase "In lieu of repeal of Section 406." No one to my knowledge suggested repeal. As a result the paragraph is ambiguous and might give the impression that though the Forum is recommending expanded use of class exemptions, our first choice is repeal of section 406. This is not the case, and for this reason, the phrase should have been deleted.

Paragraph C recommends ameliorating the ERISA reporting and disclosure burdens of small business "so far as permitted by law." The Forum clearly wanted the OPWBP to relieve the paperwork burden of small business. However, the paragraph could be interpreted as urging the agency to favor small business even when the issue is a trade off between less paperwork and beneficiary protections. I don't believe this to be the opinion of the Forum and to correct any possibility of such a false impression, the words "consistent with beneficiary protection" should have been inserted after the words "so far as permitted by law."

Policy Recommendations - The Report makes the point that the Forum's final recommendations are consistent with the Secretary of Labor's instructions that the recommendations be limited to matters concerned with Departmental organization. I did not object to this approach since it was more likely to reach a consensus and to achieve results then efforts to reach agreement on broad and controversial policy issues most of which would require difficult or impossible to pass legislation.

Since much of the Forum discussion went beyond these limitations, and included policy issues, the report includes a supplementary section on policy to which members of the Forum are invited to associate themselves. Once such recommendations are included in the report, the impression might be given that the need for policy recommendations are met by them when this was not the case for many or most members of the Forum. I do not object to the Forum's policy recommendations, but they do not go far enough. Senator Javits pointed out their inadequacy in his excellent statement read by his son to the Forum at its last meeting. I would like to be associated with most of the additional policy recommendations made by him. For example, the Forum should have at least recommended that (1) the integration of pensions under ERISA with Social Security, especially for workers in the lower brackets, should be reviewed and adjusted (2) withdrawal of Assets of overfunded plans, especially to finance takeovers or opposition to takeovers, should be the subject of legislation and (3) participation by workers in pension fund management should be considered as a mandatory requirement.

In conclusion, I generally support the recommendations of the National Pension Forum and am willing to sign the report with the understanding that I do so with the reservations stated above.

Sincerely,

Larry Smedley

Lawrence T. Smedley
Associate Director
Department of Occupational Safety,
Health and Social Security

LTS/dar
opeiu#2
afl-cio

Mr. CLAY. The next witnesses are Mr. William S. Hoffman, director of the Social Security department at United Auto Workers, and Mr. S. Howard Kline, United Steelworkers of America.

Without objection, your entire statement will be included in the record. Hopefully, you will summarize it for us.

STATEMENTS OF WILLIAM S. HOFFMAN, DIRECTOR, SOCIAL SECURITY DEPARTMENT, UNITED AUTO WORKERS, ACCOMPANIED BY ALAN REUTHER, ASSOCIATE GENERAL COUNSEL; AND S. HOWARD KLINE, UNITED STEELWORKERS OF AMERICA

Mr. HOFFMAN. Good morning, Mr. Chairman. I will summarize our testimony. Mr. Chairman, I am William Hoffman, director of the Social Security department of the international union, United Auto Workers.

Accompanying me today is Alan Reuther, associate general counsel for the UAW. On behalf of the UAW, we appreciate this opportunity to present testimony before the subcommittee concerning the components of a national retirement income policy, a subject of vital concern to the 1.5 million active and retired members of the UAW and their families.

Our Nation's retirement income policy should be directed toward providing retirees with adequate replacement of their preretirement incomes, and maintaining the purchasing power of that income during their remaining lifetimes. The UAW believes that these objectives can be best obtained by maintaining and strengthening the Social Security and Medicare Programs. In addition, the Tax Code should continue to be used to encourage the formation and growth of employer-sponsored pension plans, especially defined benefit plans which help to supplement benefits provided under Government programs.

Finally, we believe that individual savings vehicles are less desirable mechanisms for providing retirement income security, and therefore should play only a limited role in our national retirement income policy. Social Security remains the base upon which retirement income security is built. It provides almost universal coverage for the private work force; has the advantage of complete portability; and is the fairest and most efficient way to provide essential retirement income benefits to our Nation's senior citizens.

Since most Americans rely heavily on Social Security, the UAW believes that more emphasis should be placed on making benefits under the program sufficient to allow retirees to live in dignity, rather than on the brink of poverty. In particular, we believe that the percentage of preretirement income replaced by Social Security must be raised for lower income workers. These workers have the fewest resources with which to provide retirement income security through personal savings; and they are also least likely to be covered by, or be the beneficiaries of, even a minimally adequate private pension.

It is of critical importance to preserve the automatic cost-of-living adjustments under the Social Security Program, because they are crucial to providing retirees with protection against inflation. The UAW is opposed to any freeze or reduction in Social Security cost-of-living adjustments. Cost-of-living increases are part of the current law, and are counted on by retirees. Tampering with them would cause a real cut in standard of living, and simply help to further undermine confidence in the integrity of Social Security.

We cannot consider the issue of retirement income security in isolation from the cost of medical care for older Americans. For the past 20 years, Medicare has helped to alleviate the financial burden of the high health care costs incurred by our senior citizens at a time of life when most must live on reduced incomes. However, the protection afforded by Medicare has been eroded by skyrocketing health care costs.

In recent years, the Medicare Program has come under attack by those who would prefer to shift the burden of rising health care costs to our senior citizens and to the private sector. Medicare copayments, deductibles, and premiums have been increased while many Medicare costs have been shifted to private sector employers. Now the administration is proposing in its budget for fiscal 1986 to make further cuts in the Medicare Program, such as by increasing the premiums paid by beneficiaries for Medicare part B coverage.

The UAW strongly opposes any cuts in Medicare benefits. Indeed, to provide true retirement income security for the elderly, the Medicare Program ought to be expanded and improved.

The role of private pension plans: Social Security benefits represent the greatest proportion of retirement income for low- and middle-income wage earners, and a substantial portion of retirement income for higher wage earners. However, Social Security benefits alone fall far short of providing the income necessary to maintain a comfortable standard of living for the great majority of retired Americans. Accordingly, the UAW believes that there is a need for employer-sponsored, private pension plans which can provide retirees with additional pension benefits to help supplement Social Security.

We also believe strongly that defined benefit pension plans are the best vehicles for providing, in combination with Social Security benefits, a secure and adequate retirement income. These plans have the distinct advantage of making known to future pensioners the amount of income that will be available to them upon retirement, and most importantly, these benefits are guaranteed by the Federal Government. Only defined benefit plans possess the flexibility needed to provide essential benefits including meaningful surviving spouse pensions, early retirement supplements, adequate disability income, and postretirement benefit increases.

Because employer-sponsored pension plans play a crucial role in providing adequate retirement income, it is entirely appropriate for the Federal Government to use the Tax Code to create incentives for the growth and development of private pension plans. UAW is, therefore, opposed to the various proposals which have been advanced to tax earnings on private pensions as well as other employer-provided fringe benefits.

We believe that all such proposals are ill advised. The taxation of employee benefit programs will inevitably have a detrimental impact on the distribution and availability of these benefits among the work force. The additional costs and administrative burdens will reduce the willingness of employers to provide these benefits, and employees are likely to find the taxation of fringe benefits to be unacceptable, especially if it results in an increase in their tax burdens and a net reduction in take-home pay.

In the end, the taxation of employee benefits will simply undermine the network of protections for workers and retirees. In particular, the imposition of taxes on private pension plans will discourage the growth and development of such plans and thus will have an adverse impact on retirement income security of the elderly.

The UAW also believes that there is a need for certain reforms to help make the private pension system fairer and more secure. The PBGC must be strengthened by implementing a too-long delayed premium increase. The Single Employer Termination Insurance Program also needs to be reformed to prevent solvent employers from dumping unfunded pension liabilities onto the PBGC, and from evading responsibility for nonguaranteed benefits.

The UAW is also committed to reforms to help make the private pension system more responsive to the needs of those workers who do not spend all or most of their working careers with one employer. Two steps toward achieving this goal would be to liberalize vesting requirements and establish a National Pension Portability Program.

Our union recognizes that personal savings represent one of the three principal sources of retirement income. However, we want to emphasize that discretionary income of middle- and lower-income workers is often so limited as to preclude meaningful personal savings. The opportunity for personal savings is much greater among upper-income individuals. Accordingly, individual savings vehicles such as IRA's are inherently more discriminatory than employer-sponsored pension plans which must generally meet tough antidiscrimination rules. They certainly cannot serve as a substitute for broad-based Government programs such as Social Security and Medicare in providing basic retirement income security for the elderly.

For a number of reasons, the UAW is opposed to any further expansions of IRA's. First, the tax incentives for IRA's are dramatically skewed toward the wealthy. There is also substantial evidence that IRA's have simply resulted in a shift of assets from preexisting savings instead of stimulating increased savings. Finally, there is no guarantee that the moneys will actually be used for retirement income purposes.

The revenue loss, as you have heard earlier, associated with IRA's is large and growing rapidly. There was an earlier question which perhaps some further information may help clarify. If the Treasury Department proposal were to be adopted, there would be an additional revenue loss of $13.7 billion by fiscal 1990.

On behalf of the UAW, I want to thank you again for this opportunity to present our position.

[Prepared statement of William S. Hoffman follows:]

PREPARED STATEMENT OF WILLIAM S. HOFFMAN, PH.D., DIRECTOR, SOCIAL SECURITY DEPARTMENT, INTERNATIONAL UNION, UAW

Mr. Chairman, I am William S. Hoffman, Director of the Social Security Department of the International Union, UAW. The UAW appreciates the opportunity to testify before this Subcommittee concerning the components of a national retirement income policy—a subject which is of vital concern to the 1.5 million active and retired members of the UAW and their families.

While the needs of retired Americans differ somewhat from those o active workers, there are certain timeless necessities of life which are common to all and are the birthright of every citizen. The immediate and enduring physical needs for adequate housing, proper nutrition, clothing, transportation, and medical care are universal. Retired Americans, no less than the rest of the population, must have these elemental needs satisfied.

Our nation's retirement income policy should be directed towards assuring that all retirees are able to satisfy these needs. This means providing retirees with an adequate replacement of their pre-retirement income, and maintaining the purchasing power of that income for the remainder of the retirees' lives. The UAW believes that these objectives can best be attained by maintaining and strengthening the Social Security and Medicare programs. In addition, the tax code should continue to be used to encourage the formation and growth of employer-sponsored pension plans (especially defined benefit plans), which can help to supplement the benefits provided under government programs. Finally, we believe that individual savings vehicles are a less desirable mechanism for providing retirement income security, and therefore should play only a limited role in our national retirement income policy.

THE ROLE OF SOCIAL SECURITY AND MEDICARE

Social Security remains the base upon which retirement income security is built. It provides almost universal coverage for the private workforce, has the advantage of complete portability, and is the fairest and most efficient way to provide essential retirement income benefits to our nation's senior citizens. Two-thirds of the over-65 beneficiaries rely on Social Security for more than one-half of their income; a third of this age group rely on Social Security for more than 90% of their income.[1]

In contrast, although the private pension system has grown tremendously in the post-war period, still only about one-third of the population over 65 receives benefits from a private pension plan.[2] Even though more than half of the workers in the private sector are now covered under pension plans, many of them will receive little or no retirement income because of vesting standards and frequent job changes. Thus, the private pension system cannot serve as a substitute for Social Security, which is a comprehensive program designed to meet the needs of the vast majority of workers and retirees.

Since most Americans rely heavily on Social Security, the UAW believes that more emphasis should be placed on making benefits under the program sufficient so that retirees can live in dignity, rather than on the brink of poverty. In particular, we believe that the percentage of pre-retirement income replaced by Social Security must be raised for lower income workers. These workers have the least resources with which to provide for retirement income security through personal savings. And they are also least likely to be covered by or to be the beneficiaries of even a minimally adequate private pension.

It is also of critical importance to preserve the automatic cost-of-living adjustments (COLAs) under the Social Security program, since they are crucial in providing retirees with protection against inflation. The 1983 Amendments to the Social Security Act permanently cut back COLA for retirees by delaying for six months the effective date for future benefit increases and by changing the measurement formula. This permanent cut in benefits represented a $40 billion savings to Social Security for the remainder of the decade. While we were strongly opposed to this type of change when it was first proposed, we eventually accepted it as part of a bi-partisan compromise which included accelerated payroll taxes, broader coverage of the workforce, and partial taxation of benefits for higher income beneficiaries. These changes were necessary in order to secure the long-term financial health of the Social Security program.

Unlike those changes, the current proposals to freeze Social Security cost-of-living increases have no such justification. These proposals are simply designed to meet current budgetary needs of the federal government, which are unrelated to the solvency of the Social Security program. Indeed, the 1984 Report of the Social Security Trustees stated that the cash benefit programs are now soundly financed and "benefits can be paid on time well into the next century on the basis of all four sets of economic and demographic assumptions."

---

[1] Robert M. Ball, Fact Sheet #14, Study Group on Social Security.

[2] The Council of Economic Advisors report to the President in February 1985 stated that "about 30 percent of the elderly now receive pension benefits, accounting for about 15 percent of income for all elderly persons."

Accordingly, the UAW is vehemently opposed to any "freeze" or reduction in Social Security cost-of-living adjustments. The cost-of-living increases are part of current law, and are counted on by retirees. Tampering with them would represent a real cut in their standard of living. And it would simply help to further undermine confidence in the integrity of Social Security.

A national retirement income policy should also focus on various long range improvements in the Social Security system. We believe the financing of the program should be made equitable. Employers should be taxed on their total payroll, and the maximum taxable wage base for employees should be raised to a level which would reach the total earnings of most high-wage earners. These changes would provide additional Social Security revenues and would lessen the regressive nature of the present payroll tax. Further, we urge Congress to consider a permanent refundable income tax credit to offset a portion of Social Security payroll taxes. Ultimately, we believe that one-third of the cost of the program should be funded with general revenues.

Progressive financing of Social Security, combined with a full employment economy, would make possible several needed improvements in Social Security benefits. The UAW strongly urges Congress to return the age for full benefits to 65, as it was prior to the 1983 Amendments. The increase in the retirement age in the next century is bad social policy because it amounts to a future benefit cut for current workers, and because it will aggravate unemployment for younger workers. The increase in the retirement age was not needed in order to insure the solvency of Social Security. The cost of the cash benefit program is currently about 5% of GNP. Had the retirement age not been changed, the Social Security Trustees estimated that the cost of projected benefits until the middle of 21st century would have been between 5% and 6% of GNP, a stable and relatively small cost as the baby boom generation moves through the program.

The UAW also supports changes in Social Security benefits which would provide fairer treatment for women who have worked both in the home and in industry. Improvements in the benefit formula for those who have worked many years at substandard wages are needed in order to provide more equitable treatment for underpaid workers, chiefly women and minorities. And changes are also needed in the benefit formula to recognize the reduction of Social Security protection which millions of unemployed workers have suffered.

We cannot consider the issue of retirement income security in isolation from the cost of medical care for older Americans. For the past twenty years, Medicare has helped to alleviate the financial burden of the high health care costs incurred by our senior citizens at a time in their lives when most live on reduced incomes. However, the protection afforded by Medicare has been eroded by skyrocketing health care costs.

Although direct payments—the out-of-pocket expenses—for personal health care expenditures declined from 53% to 28% of total medical care expenditures for the elderly between 1966 and 1981, the level of expenditures has risen so sharply that the individual financial liability of elderly persons actually increased from $237.00 (the average 1966 out-of-pocket expense) to more than $1,500,000 per year by 1981. As a result the elderly now must devote approximately the same 15 percent of disposable income to such out-of-pocket medical costs as they did prior to the enactment of Medicare.[3] Imagine the magnitude of the crisis we would be facing now had Medicare not been enacted.

In recent years, however, the Medicare program has come under attack by those who would prefer to shift the burden of rising health care cost to our senior citizens and the private sector. Medicare copayments, deductibles, and premiums have been increased, while many Medicare costs have been shifted to private sector employers. Now, the Administration is proposing in its budget for fiscal year 1986 to make further cuts in the Medicare program, such as by increasing the premiums paid by beneficiaries for Medicare Part B coverage.

The UAW strongly opposes any cuts in Medicare benefits. Indeed, to provide true retirement income security for the elderly, the Medicare program ought to be expanded and improved.

We believe a fairer and more sensible approach to containing the cost of the Medicare program would be to enact the proposed Medicare Solvency and Health Care

---

[3] Special Committee on Aging. The United States Senate. "Medicare and the Health Costs of Older Americans: The Extent and Effects of Cost Sharing." (April 1, 1984)

Cost Containment Act of 1985 (H.R. 1801) which recently has been introduced by Representative Gephardt. The root cause of the financial problems facing the Medicare program is not that benefits are too generous or that taxes are too low; it is the waste and excessive inflation endemic to the American health care system. The Gephardt bill would address this problem through a comprehensive, system-wide reform of health care financing that would contain total health care costs. It would reduce the projected cost of Medicare and other health expenditures in the federal budget, and solve the financing problems facing Medicare, without raising taxes or cutting benefits. And, by using an "all-payor" approach, it would restrain Medicare's costs without shifting them to private sector payors.

As Congress grapples with the problems associated with health care financing, it is important that steps be taken to monitor the quality of health care which is provided to the elderly. The introduction of a prospective reimbursement methodology for hospitals under Medicare based upon Diagnois Related Groups (DRGs) appears to have had a positive impact in decreasing the rate of increase in health care expenditures. But at the same time, we are hearing about examples where elderly patients have been released from hospitals too soon, even when adequate alternatives forms of care are not available. Although we must continue to seek ways to restrain rising health care costs, insuring that the elderly receive appropriate patient care should always remain our foremost concern.

THE ROLE OF PRIVATE PENSION PLANS

Social Security benefits represents the greatest proportion of retirement income for low and middle income wage earners and a substantial proportion of the retirement income of higher wage earners. However, Social Security benefits alone fall far short of providing the income necessary to maintain a comfortable standard of living for the great majority of retired Americans.

Accordingly, the UAW believes that there is a need for employer-sponsored private pension plans, which can provide retirees with additional pension benefits to help supplement Social Security. We also strongly believe that defined benefit pension plans are the best vehicles for providing, in combination with Social Security benefits, a secure and adequate retirement income. These plans have the distinct advantage of making known to future pensioners the amount of income that will be available to them upon retirement. And importantly, these benefits are guaranteed by the federal government. Moreover, only defined benefit plans possess the flexibility needed to provide essential benefits, including meaningful surviving spouse pensions, early retirement supplements, adequate disability income and post-retirement benefit increases.

On the other hand, defined contribution plans, which are simply used to accumulate amounts in individual accounts belonging to each worker, have a number of drawbacks. The level of funds in any individual's account is a function not only of the level of plan contributions, but also of the plan's investment performance. Due to the variability of investment performance, the luck of the draw frequently determines an employee's retirement income. Furthermore, the accumulated account balance will always be too small to provide an adequate retirement income for the worker who begins participating in the plan late in his or her working career. Most importantly, too often a retiree's accumulated account balance is looked upon as an economic windfall, and is not actually used to provide retirement income. Even when the account balance is used to provide retirement income, it is difficult to provide for post-retirement increases. For these reasons, defined contribution plans are less effective than defined benefit plans in assuring retirement income security.

Because employer-sponsored pension plans play a crucial role in providing senior citizens with adequate retirement income, it is entirely appropriate for the federal government to use the tax code to provide incentives for the growth and development of private pension plans. The UAW is therefore vehemently opposed to the various proposals which have been advanced to tax the earnings on private pension plans, as well as other employer-provided fringe benefits. The 1984 tax legislation already took a step in this direction, by imposing a tax for the first time on certain "excess" reserves in voluntary employees' beneficiary associations (VEBAs), which are often used to provide retiree health insurance benefits. More recently, the Treasury Department has proposed that the earnings on all VEBA funds be subjected to taxation, and that other employer provided fringe benefits such as health and life insurance, educational assistance and pre-paid legal services benefits also be taxed. And there have been reports that proposals to tax the earnings on pension funds are being considered.

We believe that all such proposals are ill-advised. The taxation of employee benefit programs will inevitably have a detrimental impact on the distribution and availability of these benefits among the workforce. The additional costs and administrative burdens will reduce the willingness of employers to provide these benefits. And employees are likely to find the taxation of fringe benefits to be unacceptable, especially if it results in an increase in their tax burden and a net reduction in their tax-home pay. In the end, taxation of employee benefits will simply undermine the network of protections for workers and retirees. In particular, the imposition of taxes on private pension plans will discourage the growth and development of such plans, and thus will have an adverse impact on the retirement income security of the elderly.

This does not mean, however, that the UAW favors the unfettered use of tax incentives with respect to private pension plans. For example, we strongly believe that tax preferences for private pension plans should be made contingent upon stringent anti-discrimination rules, which insure that benefits are broadly distributed to all employees, not just a few upper income executives. We also believe that tax preferences should be granted only to bona fide retirement income programs, which make distributions only for retirement purposes. There is no justification for granting the same type of tax preferences to capital accumulation or "savings" vehicles, which allow monies to be used for non-retirement purposes. The limits on the pension benefits and contributions which are granted favorable tax treatment should also be reduced. There is no reason to subsidize excessive pension benefits or contributions, which simply represent a means of sheltering income from taxation, rather than a means of assuring adequate retirement income security.

The UAW also believes that there is a need for certain reforms to help make the private pension system fairer and more secure. The enactment of the Employee Retirement Income Security Act of 1974 was a watershed in the development of the private pension system. The improved participation and vesting standards, increased funding requirements, stronger fiduciary rules, and the pension guarantees provided by the Pension Benefit Guaranty Corporation, were all positive developments. More recently, the passage of the Retirement Equity Act represented a first step towards addressing various inequities faced by women under the private pension system.

But the UAW believes further improvements are still needed. The PBGC must be strengthened by implementing a too-long-delayed premium increase. The single-employer termination insurance program also needs to be reformed, to prevent solvent employers from dumping unfunded pension liabilities onto the PBGC and evading responsibility for non-guaranteed pension benefits. And reforms are urgently needed to curb the termination of well-funded plans by employers in order to recapture so-called "excess assets", which has recently been jeopardizing the retirement income security of thousands of participants.

The UAW also is committed to reforms which will help to make the private pension system more responsive to the needs of those workers who do not spend all or most of their working careers with one employer. Two steps toward achieving this goal would be to liberalize vesting requirements and to establish a national pension portability program.

Currently, a typical pension plan provides that benefits do not become vested until an employee has been a plan participant for ten years. We believe this requirement should be lowered to no more than five years. This would increase retirment benefits for employees who work for many employers during their working career, or else move in and out of the workforce.

But shortening the vesting period is not enough. Workers who satisfy the vesting requirements still will only qualify for a benefit that is *fixed* in amount when employment is terminated. Their benefits then suffer from steadily eroding purchasing power. More liberal vesting without benefit improvements subsequent to termination would be of rather limited value; although more workers would qualify for benefits, those benefits would be based on frozen amounts for short periods of service. Furthermore, eligibility for other employment related retirement benefits, such as health care and life insurance, are not provided to those only eligible for deferred vested benefits.

The establishment of a procedure allowing for the portability of private pension credits is needed in order to provide substantial improvements in retirement security for American workers. Such a reform would recognize the hard economic fact that America has a highly mobile workforce. It would also take note of the fact that this mobility is increasingly involuntary as workers are exposed to the severe social and economic dislocation triggered by plant closings and runaway shops. These workers are twice penalized—once when they are uprooted by circumstances beyond their control, and then again when they ultimately receive diminished retirement benefits. Carrying pension service from one employer to another can be a workable solution to this problem.

We recognize the development of such a program will need to address the issue of eligibility, benefit levels, funding mechanisms and administration. Yet these are not insurmountable tasks. A national private pension portability program could be established in stages. It could develop within industries and later be extended between industries. Another approach would be to require pension portability among employers receiving government contracts, starting perhaps in the defense industry. Our union has already proposed such a program to several employers in the aerospace industry.

The UAW also supports reform of the rules relating to the "integration" of private pension benefits with Social Security. In addition to being overly complex, the current integration rules permit employers to structure their plans so that benefits flow disproportionately to higher wage earners, while the lower paid employees may receive little or no benefits. Meaningful reform in this area should seek to assure that pension benefits are more evenly distributed throughout the workforce, and that all workers receive some benefits under a plan.

There has been considerable discussion about how private pension coverage can be extended to additional groups of employees. Concern has often been expressed that the administrative costs associated with establishing and maintaining a pension plan are a significant obstacle to increasing coverage, especially among employers with small numbers of employees. However, there are existing mechanisms which pool administrative functions, thereby providing cost savings and administrative ease. The UAW has had extensive experience with one such plan (the National Industrial Group Pension Plan) since late 1965. Currently, this Plan includes some 800 employer groups nationwide, covering nearly 50,000 people. We believe that this type of plan can provide a partial solution to the "coverage" problem.

For a number of reasons, the UAW is concerned about the recent proliferation of 401(k) plans. First, unlike traditional types of retirement income plans, under a 401(k) plan there is no requirement that all employees actually participate in the plan. Typically, employers make matching contributions for those employees who decide to contribute to the plan via salary reduction. Although the plan must meet a "utilization" test, the employer still is not required to make contributions on behalf of all employees, and all employees do not have to participate in the salary reduction program.

In our judgment, this represents a bad precedent, and runs counter to efforts to assure greater worker participation under the private pension system. We would therefore support measures to tighten the "utilization" or discrimination rules for 401(k) plans, so as to require employers to make uniform contributions on behalf of all employees.

Second, the distribution rules for 401(k) plans are much more lax than for other types of retirement income vehicles. As a result, monies contributed to 401(k) plans are often being used for non-retirement purposes. And there is an incentive to use these plans as a tax avoidance mechanism, rather than as bona fide retirement vehicles. The UAW therefore supports making the distribution rules for 401(k) plans more restrictive.

Third, to prevent 401(k) plans from being used as a tax avoidance device, the UAW supports lowering the limits on the amounts employees can contribute to such plans via salary reduction. Limiting employee contributions to $2,000 (the same as the IRA limits) would be more equitable, and would also help to reduce the revenue loss associated with 401(k) plans.

INDIVIDUAL SAVINGS

The UAW recognizes that personal savings represent one of the three principle sources of retirement income. However, the discretionary income of middle and lower income workers is often so limited as to preclude meaningful personal savings. And the opportunity for personal savings is much greater among upper income individuals. Accordingly, individual savings vehicles, such as IRAs, are inherently more discriminatory than employer sponsored pension plans, which must generally meet tough antidiscrimination rules. And they certainly cannot serve as a substitute for broad-based government programs, such as Social Security and Medicare, in providing basic retirement income security for the elderly.

For these reasons, the UAW is troubled by the recent tendency to increase the tax incentives for individual savings vehicles at the expense of government programs and employer sponsored pension plans. Although IRAs were originally conceived as a savings vehicle for persons not covered under employer-sponsored pension plans, they were made universally available as part of the 1981 tax legislation. More recently, the Treasury Department has proposed that the contribution limits for IRAs be expanded so that individuals can contribute $2,500 to both regular and spousal IRAs.

For a number of reasons, the UAW is opposed to any further expansion of IRAs. First, the tax incentives for IRAs are dramatically skewed towards the wealthy. In 1982, the highest paid 15% of the working population established 50% of all IRAs.[4] This is hardly surprising, since upper income individuals have more disposable income available for savings, and since the deduction for IRA contributions is worth more to persons in higher tax brackets.

Second, there is substantial evidence that IRAs have simply resulted in a shift of assets from pre-existing savings, instead of stimulating increased savings. Indeed, 54% of all IRA contributions in 1982 came from pre-existing savings.[5]

Third, there is no guarantee that the monies contributed to IRAs will actually be used for retirement income purposes. Because the penalty for early withdrawals is so low, there currently is an incentive for individuals to use IRAs as a tax avoidance, capital accumulation device, and to withdraw their contributions after a relatively short period of time.

Fourth, the revenue loss associated with IRAs is large, and growing rapidly. In 1982, the tax deduction associated with IRAs was $28.4 billion. If the Treasury Department proposal were to be adopted, this would result in an additional revenue loss of $13.7 billion by fiscal year 1990. A revenue loss of this magnitude simply cannot be justified in these times of record budget deficits.

In view of these problems, the UAW vehemently opposes further expansion of IRAs. In addition, we would support various proposals to curb or redirect the tax expenditure for IRAs, including: (1) returning to the pre-1981 situation, where IRAs were only available to persons not covered under an employer-sponsored pension plan; or (2) converting the IRA deduction to a tax credit, and phasing the tax credit out at upper income levels. At the very least, Congress should offset any contributions made by employees to 401(k) plans against the employees' IRA limits, in order to prevent "double dipping". Finally, in order to encourage the use of IRA contributions for retirement income purposes, we would support increasing the penalty on premature withdrawals to 20%.

CONCLUSION

On behalf of the UAW, I want to again thank you Mr. Chairman for the opportunity to present our views on a national retirement income policy. The issues associated with the development of a national retirement income policy are among the most important ones confronting Congress today. We hope this Subcommittee will consider our views in the course of its deliberations on this issue.

Mr. **Hayes** [presiding]. Mr. Kline.

Mr. **Kline**. Thank you, Mr. Chairman.

My name is Howard Kline. I am counsel for employee benefits for the United Steelworkers of America. I am testifying on behalf of our president, Lynn Williams.

Mr. Chairman, the United Steelworkers is pleased to have the opportunity this morning to testify. We have long believed that all working people and all members of our society have a fundamental right to enjoy in retirement a life of dignity and self-respect, and that both employers and the Government have an obligation to provide the retirement income and insurance protection essential to the attainment of this goal.

For this reason, we have consistently supported the expansion of the Social Security and the Medicare Programs in the Government sector, and the expansion of pension plans and retiree insurance programs in the private sector. We are proud of the fact that there are today hundreds of thousands of retired steelworkers who are able to enjoy their retirement years in large part because of their union's efforts. We are also mindful that there are hundreds of thousands of active union employees today and millions of other working people who look to their unions and to their Government to preserve and expand these benefits to permit future retirees the same measure of dignity and self-respect in their retirement years.

---

[4] Employee Benefit Research Institute, Issue Brief #32, July, 1984.

[5] Ibid.

Our union believes that we should continue to rely primarily on the combination of Government-provided Social Security and Medicare, employer-provided pension and retiree insurance and, to a lesser extent, on employee-provided personal savings as the means by which working people are to be assured of retirement income security.

Each of these three components is directly affected by the Federal Government's activities, yet it is increasingly clear to us that there exists a structural deficiency in the way the Federal Government goes about making policy that will directly and vitally affect each of these three components. To be blunt, the Federal Government does not really have a policy for encouraging retirement income security, nor does it have the mechanism to develop such a policy.

The jurisdictional divisions on Capitol Hill have already been alluded to; we recognize that this division among the various congressional committees is perhaps inevitable, and is not limited in the Congress to the issues being considered today. Nevertheless, as the budget crisis continues year after year, and the attention of the Congress is increasingly focused on tax loss and tax revenue considerations, we fear that this jurisdictional division will result in less and less interest being shown in the social and labor relations implications of congressional decisions relating to retirement income security.

In the executive branch, the problem is even worse, for there regulatory jurisdiction is divided between the Treasury Department, the Social Security Administration, the Labor Department, the Pension Benefit Guaranty Corporation, and other Federal agencies as well. Perhaps most distressing is the fact that there appears to be no institutional need for this division of jurisdiction. That the executive branch, both now and in the past, has never been able to develop a coherent, comprehensive policy relating to these retirement income security issues is clear.

We doubt that the Federal Government will ever be able to develop a sound, national retirement income security policy until the Congress mandates the consolidation of most executive branch regulatory activities relating to employee benefits plans and retirement issues into a single agency with the prestige and the resources of a Cabinet-level Department or an independent agency.

Because Social Security retirement coverage and Medicare health insurance coverage are virtually universal, the preservation and expansion of the current level of benefits are clearly essential to the ability of working people to achieve a meaningful level of retirement income security. Regardless of one's feelings about individual retirement accounts, personal savings, and employer's obligation to provide pension coverage, retiree insurance, and other forms of deferred compensation, for millions upon millions of working Americans and their families, the only meaningful retirement income they will have in the foreseeable future is their Social Security benefits. The only meaningful retiree insurance coverage they will have in the foreseeable future will be Medicare.

It is indisputable that the retirement income security of working people is directly dependent on the preservation and expansion of these benefits. Any proposal to reduce these vital benefits can only result in the reduction of retirement income security for all of us, but particularly for those among us who have nothing else to rely upon in retirement.

We have always believed that the private sector should be encouraged to establish, maintain, and fund pension and retiree insurance programs as fundamental elements of the wage and benefit package which the employee receives in exchange for his labor. We are secure in our continuing endorsement of such tax expenditures because we believe that these expenditures have served society's interests as well as the interests of those covered under our benefit programs.

Most fundamentally, these programs have been fair. They have provided roughly equal benefits to large numbers of working people in accordance with the nondiscrimination requirements of the Internal Revenue Code and general principles of fairness. In this regard, we continue to believe that strict discrimination requirements must be necessary elements for all tax-subsidized savings and retirement programs. We also continue to support faster vesting, broader participation and coverage, increased portability and other mechanisms by which the basic fairness of these programs can be enhanced.

In addition to being fair, the availability of these tax-subsidized, group-oriented fringe benefits have served society's interests by facilitating relatively peaceful labor relations. Few unions and few employers, we suggest, would relish trying to reach a settlement at the bargaining table if the economic value of the wage and benefits package were suddenly reduced because employees had to pay income tax on all or part of the value of their pension and insurance benefits. In addition, the demands placed on Social Security, Medicare, Medicaid, and numerous other social-welfare programs would have been greatly diminished because retirement income and retiree insurance coverage have been available to millions of workers through tax-subsidized pensions and retiree insurance programs.

With regard to individual retirement accounts, Mr. Chairman, we are sharply critical of the availability of IRA's to all persons with earned income, regardless of whether they are covered under qualified pension plans and regardless of their total income. We are likewise sharply critical of proposals to expand the IRA contribution limit. We are critical of IRA's for the very same reasons that we favor the continuation of tax subsidies for qualified pension plans and retiree insurance programs. IRA's are unquestionably unfair. Though almost everyone has the opportunity to establish an IRA, it is clear that only the upper middle class and the wealthy, in fact, take advantage of this tax subsidy to any significant degree.

In an era of severe budget deficits in which vital social programs are being curtailed or eliminated, why should a tax shelter which disproportionately benefits the well-to-do and causes an annual loss of revenue to the Federal Government be preserved, much less expanded? If more personal savings is the goal, then it should be accomplished in a way that does not discriminate in favor of the wealthy. If capital accumulation is the goal, then it too should be accomplished in a nondiscriminatory manner.

In establishing the Medicare program two decades ago, Congress recognized that in order for our senior citizens to live in retirement with decency and a modicum of independence and self-respect, they must have access to quality medical care at reasonable costs. Our union has long shared this belief, and we are proud to have won for hundreds of thousands of our retired members insurance protection which provides both substantial insurance coverage for retirees who are not yet eligible for Medicare, and fills in the gaps not covered by Medicare once the retiree becomes eligible for that coverage.

We are currently faced with numerous situations in which employers, although profitable and solvent, attempt to escape their retiree insurance obligations. We urge the subcommittee to investigate this problem which is threatening the retirement income security of retirees who traded wage increases while actively employed in exchange for a promise of lifetime insurance protection in retirement.

Mr. Chairman, our union has supported the single employer termination insurance program from the inception of ERISA. The need for a Government-sponsored insurance program funded by premiums paid by employers to provide pension benefits to retirees of employers who, for whatever reason, fail to fund their pension promises, is well established. Indeed, the tragic industrial depression of the last few years which has so dramatically affected our basic industries and the people who labor there has clearly demonstrated that the maintenance of a meaningful termination insurance program is a fundamental obligation of the Federal Government.

We have supported responsible efforts to improve the existing termination insurance program by raising the insurance premiums to a more realistic level, and closing the so-called dumping loophole in current law. As the subcommittee is well aware, these efforts have bogged down. We are committed to continue our efforts to reform title IV to preserve the existing level of guaranteed benefits and in fact to expand it and to close the loopholes.

Pending the resolution of this legislative endeavor, however, we urge the Congress to increase the annual per capita premium in the single employer program substantially in order to finance the single employer termination insurance program on a sound basis. We note that in so doing the Congress would also reduce the deficit in a way which helps active and retired workers in a meaningful way, yet does not increase taxes.

In conclusion, our Union believes that the establishment of meaningful retirement income security for all Americans is one of the fundamental obligations of our Federal Government. Beginning with the enactment of the Social Security Program 40 years ago, Congress, by establishing tax incentives for nondiscriminatory pension and retiree insurance programs, creating Medicare and enacting ERISA, has shown a willingness to satisfy that obligation. The current budget threatens to divert the Congress' attention in other directions to the detriment of the retirement income security needs of all Americans.

We have tried today to suggest ways in which you might continue in the fulfillment of that obligation. On behalf of our members and all working people, we stand ready to work with the subcommittee and the entire Congress to make the goal of meaningful retirement income security for all Americans a reality. Thank you very much.

[Prepared statement of Lynn R. Williams follows:]

[From the Steelworkers Legislative Newsletter, Apr. 2, 1985]

RETIREMENT INCOME SECURITY

USWA testifies in support of a reliance upon a combination of government-provided Social Security and Medicare *and* employer-provided pension systems. Spokesman highlighted:

lack of coordination among congressional committees and administrative agencies;

need for continuing tax code support of employee benefit programs;

criticism of Individual Retirement Accounts (IRA's)

concern about employers' tendency to escape retiree insurance obligations. Congressional action may be necessary to correct abuse;

support for defined benefit plans, i.e., worker is entitled to benefits based upon years of service;

success of government insurance of pension guarantees through ERISA. Union recognizes current need to increase premiums to PBGC. Separate legislation should also be enacted to prevent "dumping" or arbitrary termination of pension plans.

PREPARED STATEMENT OF LYNN R. WILLIAMS, PRESIDENT, UNITED STEELWORKERS OF AMERICA

INTRODUCTION

The United Steelworkers is pleased to have the opportunity this morning to testify before the Subcommittee on Labor-Management Relations. Our Union has long believed that all working people and all members of society have a fundamental right to enjoy in retirement a life of dignity and self-respect and that both employers and the government have an obligation to provide the retirement income and insurance protection essential to the attainment of this goal. For this reason, we have consistently supported the expansion of the Social Security and Medicare programs in the government sector and the expansion of pension plans and retiree insurance programs in the private sector. We are proud of the fact that there are today hundreds of thousands of retired Steelworkers who are able to enjoy their retirement years in large part because of their Union's efforts. We are also mindful that there are hundreds of thousands of active Steelworker employees and millions of other working people who look to their Union and their Government to preserve and expand these benefits to permit future retirees the same measure of dignity and self-respect in their retirement years.

We are pleased that the Subcommittee is focusing on the broad issues ~~of the~~ importance of employee benefits to society and the roles of the public and private sectors in providing retirement income security. Too often we all become so closely involved in the details of pressing problems that we fail to step back and view this subject from a broader perspective.

Our Union believes that we should continue to rely primarily on the combination of government-provided Social Security and Medicare, employer-provided pension and retiree insurance and to a lesser extent on employee-provided personal savings as the means by which working people are to be assured of retirement income security.

NATIONAL RETIREMENT INCOME SECURITY POLICY NEEDED

Of key importance is the manner in which the federal government will encourage or discourage each of these three components. Clearly the government's role is central. Social Security and Medicare, the first component, is entirely controlled by the federal government. Private sector pension and retiree insurance programs are obviously heavily influenced by the regulatory environment established by the federal government. Private savings, the third component, is similarly influenced by the degree to which the government taxes both earned and unearned income.

It is increasingly clear to us that there exists a structural deficiency in the way in which the federal government goes about making policy that will directly and vitally affect each of these components. To be blunt, it is clear that the federal government does not really have a policy for encouraging retirement income security nor does it have the mechanism to develop such a policy. In Congress, for example, jurisdiction over Social Security, Medicare, the taxation of employee benefit plans and individual savings is lodged in one Committee while jurisdiction over the remaining aspects of employee benefit plans is lodged elsewhere. Conflicts in goals, direction and degree are resolved only haphazardly and often in the heat of conference committee deliberations where long-term policy considerations are likely to yield to the exigencies of the moment. We recognize that this jurisdictional division is perhaps inevitable and is not limited in the Congress to the issues being considered today. Nevertheless, as the budget crisis continues year after year and the attention of the Congress is increasingly focused on tax-loss and tax-revenue considerations, we fear that this jurisdictional division will result in less and less interest being shown in the social and labor relations implications of Congressional decisions relating to retirement income security. For example, each time Medicare benefits are reduced, the cost of employer-sponsored Medicare "carve-out" retiree insurance programs is increased, directly affecting both active and retired employees as well as those industries in which such benefits are widespread. Yet little consideration is given to such concerns as Congress searches for ways of reducing the general deficit and financing Medicare benefits.

In the executive branch, the problem is even worse, for there regulatory jurisdiction is divided between the Treasury Department, the Social Security Administration, the Labor Department and the Pension Benefit Guaranty Corporation. Perhaps most distressing is the fact that there appears to be no institutional need for this division of jurisdiction. That the executive branch—both now and in the past—has never been able to develop a coherent and comprehensive policy relating to these retirement income security issues is clear. Consider, for example, the recent activities of the IRS, PBGC and Department of Labor regarding the reversion to plan sponsors of the assets of terminated pension plans. After developing a supposedly unified position on this important issue, the IRS issued a ruling suggesting that it is permissible to completely circumvent that position, only to withdraw the ruling for further consideration following sharp protests by the Department of Labor and the Pension Benefit Guaranty Corporation.

We doubt that the federal government will ever be able to develop a sound national retirement income security policy until the Congress mandates the consolidation of most executive branch regulatory activities relating to employee benefit plans and retirement issues into a single agency, with the prestige and resources of a Cabinet-level department or an independent agency.

SOCIAL SECURITY AND MEDICARE

Because Social Security retirement coverage and Medicare health insurance coverage are virtually universal, the preservation and expansion of the current level of benefits are clearly essential to the ability of working people to achieve a meaningful level of retirement income security. Regardless of one's feelings about individual retirement accounts, personal savings, an employer's obligation to provide pension coverage, retiree insurance and other forms of deferred compensation, for millions upon millions of working Americans and their families the only meaningful retirement income they will have in the foreseeable future is their Social Security benefits and the only meaningful retiree insurance coverage they will have in the foreseeable future will be Medicare. It is indisputable that the retirement income security of working people is directly dependent on the preservation and expansion of Social Security and Medicare. Any proposal to reduce these vital benefits can only result in the reduction of retirement income security for all of us and particularly for those among us who have nothing else to rely upon on retirement.

PRIVATE SECTOR PENSION AND RETIREE INSURANCE PLANS

We have always believed that the private sector should be encouraged to establish, maintain and fund pension and retiree insurance programs as fundamental elements of the wage and benefit package which the employee receives in exchange for his labor. Obviously, our members and working people everywhere have benefited tremendously from the tax savings associated with tax-qualified pension and retiree insurance programs.

We are secure in our continuing endorsement of such tax expenditures because we believe that these expenditures have served society's interests as well as the interests of those covered under our benefit programs. Most fundamentally, these programs have been fair; they have provided roughly equal benefits to large numbers of working people in accordance with the non-discrimination requirements of the Internal Revenue Code and general principles of fairness. In this regard, we continue to believe that strict non-discrimination requirements must be necessary elements for all tax-subsidized savings and retirement programs. We also continue to support faster vesting, broader participation and coverage, increased portability and other mechanisms by which the basic fairness of these programs can be enhanced.

In addition to being fair, the availability of these tax-subsidized, group oriented fringe benefits have served society's interest by facilitating relatively peaceful labor relations. Few unions and few employers, we suggest, would relish trying to reach a settlement at the bargaining table if the economic value of the wage and benefits package were suddenly reduced because employees had to pay income tax on all or part of the value of their pension and insurance benefits. In addition, the demands placed on Social Security, Medicare, Medicaid and numerous other social welfare programs have been greatly diminished because retirement income and retiree insurance coverage have been available to millions of workers through tax-subsidized pension and retiree insurance programs.

We are, of course, aware that some in the Executive Branch would eliminate the tax subsidies associated with these benefits. These critics argue that because these fringe benefit programs are most often sponsored by large employers in older, heavily-organized industries, it is inappropriate to subsidize these programs through the Internal Revenue Code.

We believe that the argument of these critics is without merit. What is wrong with the system is not that many large employers in heavily organized industries have seen fit to establish and maintain meaningful pension and retiree insurance programs covering their employees in a non-discriminatory fashion; what is wrong with the system is that so many other employers have failed to establish these programs which are so necessary to the retirement income security of their employees.

INDIVIDUAL RETIREMENT ACCOUNTS

We are sharply critical of the availability of IRA's to all persons with earned income, regardless of whether they are covered under qualified pension plans and regardless of their total income. We are likewise sharply critical of proposals to expand the IRA contribution limits.

We are critical of IRAs for the very same reasons that we favor the continuation of tax subsidies for qualified pension plans and retiree insurance programs. IRAs are unquestionably unfair. While almost everyone has the opportunity to establish an IRA, it is clear that only the upper-middle class and the wealthy in fact take advantage of this tax subsidy to any significant degree. How many people earning $10,000 $20,000 or even $30,000 a year can afford to establish an IRA?

In an era of severe budget deficits in which vital social programs are being curtailed or eliminated, why should a tax shelter which disproportionately benefits the well-to-do and cause a huge annual loss of revenue to the federal government be preserved, much less expanded? If more personal savings is the goal, then it should be accomplished in a way which does not discriminate in favor of the wealthy. If capital accumulation is the goal, then it, too, should be accomplished in a non-discriminatory manner.

RETIREE INSURANCE PROGRAMS

Congress, in establishing the Medicare program two decades ago, recognized that in order for our senior citizens to live in retirement with decency and a modicum of independence and self-respect, they must have access to quality medical care at reasonable cost. The United Steelworkers of America has long shared this belief and we are proud to have won for hundreds of thousands of our retired members insurance protection which provides both substantial insurance coverage for retirees who are not yet eligible for Medicare and fills in the gaps not covered by Medicare once the retiree becomes eligible for Medicare.

We are currently faced with numerous situations in which employers, although profitable and solvent, attempt to escape their retiree insurance obligations. We urge the Subcommittee to investigate this problem, which is threatening the retirement income security of retirees who traded wage increases while actively employed in exchange for a promise of lifetime insurance protection in retirement.

We also urge the Congress to clarify that those employers who maintain non-discriminatory retiree insurance programs and seek to pre-fund these obligations will not be discouraged from doing so by making retiree insurance trust funds subject to funding limitations which were designed to prevent tax abuse in discriminatory programs. Surely it makes sense to encourage employers to fund these open-ended obligations and thereby secure for retirees what is otherwise merely an unfunded promise to pay insurance premiums in the future.

DEFINED BENEFIT PLANS

Our Union continues to believe that defined benefit plans best serve the retirement income needs of our members. Defined benefit plans, in conjunction with Social Security, provide a predictable stream of retirement income to workers. In defined benefit plans, benefits are not directly related to the investment performance of the pension fund, thereby insulating the worker from the risk that his expected pension benefit will suddenly decrease because of a declining stock or bond market. Defined benefit plans are largely passive from the employee's perspective; that is, once the plan is established and benefit levels periodically adjusted, the employee is free from having to decide what part of next month's paycheck he wants to set aside for basic retirement income purposes. Finally, the availability of termination insurance through the Pension Benefit Guaranty Corporation protects the worker's pension benefits against the employer's failure to fund these promises.

We are not per se opposed to plans in which the employee has broad discretion regarding his degree of participation, the manner in which his account is to be invested and the time at which he can withdraw funds credited to his accounts. So long as such plans are non-discriminatory and suplemental to Social Security retirement benefits and predictable, assured pension benefits, we believe that they afford opportunities for savings to many of our members. Defined benefit plans, in our view, still represent the best means of providing basic retirement income to working people.

PENSION BENEFIT GUARANTY CORPORATION

The United Steelworkers of America has supported the single employer termination insurance program from the inception of ERISA. The need for a government sponsored insurance program, funded by premiums paid by employers, to provide pension benefits to retirees of employers who for whatever reason fail to fund their pension promises is well-established. Indeed, the tragic industrial depression which over the last few years has so dramatically affected our basic industries and the people who labor there has clearly demonstrated that the maintenance of a meaningful termination insurance program is a fundamental obligation of the federal government. We have supported responsible efforts to improve the existing termination insurance program by raising the insurance premiums to a more realistic level and closing the so-called "dumping" loophole in current law whereby solvent employers may find it profitable in certain circumstances to terminate plans and have the PBGC assume the unfunded, guaranteed liabilities. As the Subcommittee is well aware, these efforts have bogged down in large part because of the complexity involved in closing the loopholes in a sensible and equitable way. We are committed to continue our efforts to reform Title IV to preserve the existing level of guaranteed benefits and close the loopholes. Pending the resolution of this legislative endeavor, however, we urge the Congress to increase the annual per-capita premium in the single employer program substantially in order to continue to finance the single employer termination insurance program on a sound basis. We note that in so doing the Congress would also reduce the deficit in a way which helps active and retired workers in a meaningful way and does not increase taxes.

INVESTMENT OF PLAN ASSETS

We continue to believe that the assets of pension plans must be invested prudently and exclusively for the benefit of plan participants and beneficiaries. Any use of plan assets by corporate management for other purposes (such as to oppose a corporate takeover or to finance an employee takeover of a company) must continue to be prohibited under ERISA.

CONCLUSION

We believe that the establishment of meaningful retirement income security for all Americans is one of the fundamental obligations of our federal government. Beginning with the enactment of the Social Security program 40 years ago, Congress, by establishing tax incentives for non-discriminatory pension and retiree insurance programs, creating Medicare and enacting ERISA, has shown a willingness to satisfy that obligation. The current budget crisis threatens to divert the Congress' attention in other directions, to the detriment of the retirement income security needs of all Americans. We have tried today to suggest ways in which you might continue in the fulfillment of that obligation. On behalf of our members and all working people, we stand ready to work with the Subcommittee and the entire Congress to make the goal of meaningful retirement income security for all Americans a reality.

Mr. HAYES. Thank you, and I want to thank both witnesses for what has been excellent testimony. I would suggest that if you will be patient and bear with us a few minutes to go cast our vote, and we may want to ask you some questions about your testimony. Please just relax for that 10 minutes.

[Whereupon at 12:06 p.m., the subcommittee briefly recessed for purposes of a vote on the floor of the House.]

Mr. HAYES. Would all present be seated so that we can resume our hearings.

I would like to direct a question to both panelists: Despite recent changes in the Age Discrimination in Employment Act, and in Social Security, encouraging employees to work longer, employees still generally prefer to retire early. In fact, studies show that the average age of retirement is 62.

Should Congress amend ERISA to encourage later retirement?

Mr. HOFFMAN. Encourage later retirement? Mr. Chairman, I think the laws of the land really have to respect the variability of various types of work forces, and give the opportunity to those work forces to do what is best for them.

We would like to see the kind of flexibility that would allow people to work longer. At the same time, it has been our experience, confirming the comment you made, representing workers concentrated in heavy metal industries—although we do have workers in other industries—that the emphasis needs to be on a secure retirement as early as possible after 30 years, or 40 years, in work. That is the emphasis that we have been pursuing, and I would suggest, in response to your question, that be the approach Congress would take.

Mr. HAYES. Mr. Kline?

Mr. KLINE. Mr. Chairman, the United Steelworkers of America essentially shares that view. Most of our pension plans do not discriminate against senior, older workers. They permit senior employees to accrue the pension credit to the same extent that younger employees accrue pension credit. In that sense, I don't think that ERISA needs to be changed. We have accomplished that in most of our negotiating situations.

On the one hand, we are anxious to have employees retire with a secure pension so that they can enjoy their retirement years and open up jobs for some younger people. On the other hand, as a matter of personal right, we do not, as a general matter, believe that people ought to be forced to retire merely because they reach a certain age.

Mr. **Hayes**. Do either of you have any idea as to how we may broaden participation of lower income workers in the private pension system, and increase the likelihood of their receiving benefits, since that number seems to be growing?

Mr. **Hoffman**. I think that is probably the toughest problem that we face; I think that has been recognized. The ultimate answer, one that is not very practical at the present time, is expansion of the Social Security system. Having said that, I think there are some other things that we can do so that, in situations where individuals are not covered by private pensions, it might be possible for employer contributions, to an IRA vehicle, to be made. That is clearly not the preferred arrangement. We would rather see the establishment of defined benefit plans in those situations. To some degree, improving pension portability and establishing earlier vesting would also be helpful in broadening participation.

I think it also would be helpful if, out of your deliberations, a statement of purpose and goals emerged from this body reaffirming the need to encourage private pension plans in all respects. I think we need to have that statement made again by Congress.

Mr. **Kline**. I think faster vesting, Mr. Chairman, addresses the problem in the sense that at least some employees who participate in a plan now, but never vest, would become vested and, hence, they would no longer be completely dependent on Social Security.

I agree with the UAW representative that the obvious way to provide more retirement income to lower-paid workers is to expand Social Security, which is weighted in favor of lower-compensated workers now and provides for virtually universal coverage. We historically have supported that approach to the problem.

Mr. **Hayes**. Mr. Chandler?

Mr. **Chandler**. Rather than pose a question to you, let me just make an observation. The questions just asked by Mr. Hayes, I think, address retirement income policy, which is what we are dealing with here. All of the witnesses dealt mostly with the specifics of tax law. I thought maybe it was because of a reluctance to take a position on these issues, and yet, in your responses, you were pretty candid with him about what your position is. I would just say that what I intend to do is to put in written form questions to each of you, and all of those who have testified already; the policy-kinds of questions. Everybody said we ought to have a retirement income policy. But I want to know what do you think it ought to be? Anybody can ask the question, but answering it is a lot harder.

I think the statement that we need an adequate retirement replacement income is OK, but I want to know what is adequate. When should retirement begin, as Mr. Hayes posed. What should be the policy on lump sum distribution? Should we reward, in essence, lump sum distributions which we now do? What should be the policy on covered versus uncovered, which you just addressed? How should we deal with survivors? Should there be a difference in the way we deal with survivors as opposed to the covered worker?

What I would like to do is pose those questions to you; get written answers.

Thank you very much for your testimony.

Mr. HAYES. Did you want to add anything?

Mr. HOFFMAN. Yes, if I may. Of course, we welcome that opportunity. I think, though, that I was reading something into your question that I just want to reflect on for a second.

I don't think it is desirable to deal with any one of those issues as if there were one concrete answer. It might be that there need to be different kinds of replacement ratios for different workers at different income levels. It may be that different industries should have different types of retirement policies, each one appropriate to its own setting. Our response will start from the needs of individuals and then build back on how to do that. The variability of individuals, since we are starting with individuals, will be the overriding concern in our response.

Mr. HAYES. Thank you very much to both of you gentlemen. It has been excellent testimony.

Mr. CLAY. The next witnesses will consist of a panel. They are Hartzel Lebed; Robert S. Stone; and George Cowles.

Without objection, your entire statements will be entered in the record. We hope very much that you will summarize those and in particular emphasis points that have not been made already today.

STATEMENTS OF HARTZEL Z. LEBED, PRESIDENT OF CIGNA CORP., REPRESENTING THE AMERICAN COUNCIL OF LIFE INSURANCE AND THE HEALTH INSURANCE ASSOCIATION OF AMERICA; ROBERT S. STONE, SENIOR CORPORATE COUNSEL, IBM, REPRESENTING THE ERISA INDUSTRY COMMITTEE; AND GEORGE COWLES, SENIOR VICE PRESIDENT, BANKERS TRUST, REPRESENTING THE AMERICAN BANKERS ASSOCIATION

Mr. LEBED. Thank you, Mr. Chairman and members of the subcommittee. I am Hank Lebed, and I am president of the Cigna Corp., and I am here this morning on behalf of the American Council of Life Insurance and the Health Insurance Association of America.

We very much appreciate the opportunity to comment on issues of vital concern: The role of employee benefits in providing economic security to millions of American workers, retirees and their families, and how a well-reasoned national retirement policy can enhance that role.

Concerns over the Federal deficit are threatening tax-favored life, health, and retirement benefits for employees. Conscientious tax policy has, for many years, fostered these benefits with the excellent result that the majority of Americans have health and income protection and thus, family security. The decision of Congress to grant tax-favored status to these benefits is based on sound social policy. The rationale for this policy is as valid as ever, and the results speak for themselves.

Some tax reformers advocate repealing this favored tax treatment in the name of broadening the tax base. They cite estimates of revenue losses in support of their arguments. But estimates of revenue loss ignore the social value of employee benefits. That is, the value of economic security for millions of American workers, retirees and their families in the face of disability, old age, or the death of a breadwinner.

We believe that before fundamental changes are made, Congress should consider these questions: Are social policy decisions that have been so successful over the years now obsolete? Are the private sector decisions encouraged by the Tax Code no longer in the public interest? Will the expected benefits that might flow from proposed changes clearly outweigh the many negative social impacts which we believe are sure to follow?

With that in mind, let me turn to the specific issue of retirement income policy in which this committee is so interested. The ACLI believes that the Nation's retirement system works. There is room for improvement, but overall, the joint venture between plan sponsors and Government has resulted in ever-increasing old age security for most American workers. We believe that an explicit national retirement income policy is quite desirable. It could provide a needed framework to evaluate legislative proposals to fine tune the current system. The dominant purpose of such a policy, in our view, should be to ensure extensive coverage and adequate retirement income through an affordable private system.

ERISA greatly strengthened our private retirement system, but it did not establish an explicit retirement income policy. Without clear policy guidelines, there is a tendency to view decisions impacting our retirement income system from a perspective that is too short-term in nature. We support development of a national retirement income policy to provide adequate, affordable retirement income levels for all workers, and in addition, to promote the capital formation so necessary for sustained economic growth.

Also, individuals and their employers should be encouraged, through specific legislative incentives, for employer-sponsored pension plans and individual private savings to build upon the basic floor of protection provided by Social Security.

The ACLI and HIAA wish to be constructive participants in the development of a national retirement policy. Toward this, I will briefly mention five issues which are discussed fully in our written statement. The first is coverage. There is a misperception that coverage is not widespread. On the contrary, studies commissioned by the ACLI indicate that coverage under private pension plans is widespread and, as our present system matures, the percentage of families receiving pension benefits will increase quite sharply. Benefits will be widely distributed among all income levels.

The second issue is vesting. In our view, the existing ERISA vesting standards are reasonable. Any acceleration in vesting schedules should be undertaken voluntarily by plan sponsors, and over time, such improvements have been taking place. We doubt that mandating 5-year, 100-percent vesting, for example, will provide a significant increase in the number of workers receiving benefits. Most turnover occurs in the first 3 years of employment. Mandated earlier vesting schedules will result in increased costs for some employers, at least, and probably lead to increased plan terminations and fewer new plans.

Third, in regard to the integration of private pension plans with Social Security, we would support reform to simplify and update integration rules. That has not been done for many years.

Fourth, on the relative roles of defined benefit and defined contribution plans, we believe strongly that the retirement system is best served by the availability of a variety of vehicles to accommodate the differing needs of a diverse work force. For this reason, we oppose Treasury's proposal which creates disincentives for employee savings through defined contribution plans. We also oppose the proposal to repeal so-called 401(k) plans, which have, in just a few years, become an extremely effective savings vehicle.

Fifth, as to employer-sponsored versus individual retirement savings programs, we believe that employer-sponsored plans provide wider coverage and greater participation at all income levels. For example, participation results of 401(k) plans are four to five times greater than under IRA plans. Further, there is better participant protection under employer-sponsored plans because of stringent fiduciary responsibility requirements.

By way of summary, Mr. Chairman, we need careful legislation derived from full discussion and open debate; not decisions based on tax policy or revenue raising alone. At stake is the security of millions of Americans today and in future generations. A national retirement income policy can be an important means to develop careful solutions targeted to improve, rather than disrupt a system that is already very good.

Thank you for the opportunity to present our views. I will be happy to answer any questions you have.

[Prepared statement of Hartzel Z. Lebed follows:]

PREPARED STATEMENT OF HARTZEL Z. LEBED, PRESIDENT, CIGNA CORP., ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE AND HEALTH INSURANCE ASSOCIATION OF AMERICA

Mr. Chairman and members of the subcommittee, my name is Hartzel Z. Lebed. I am President of the CIGNA Corporation and am speaking to you this morning on behalf of the American Council of Life Insurance ("ACLI") and the Health Insurance Association of America ("HIAA"). The ACLI is a trade association with a membership of 615 life insurance companies. In the aggregate these companies account for approximately 95 percent of the life insurance in force in the United States and hold 97 percent of the assets of insured pension plans. The HIAA has 350 members who write over 85 percent of the commercial accident and health insurance in the United States. Most of the members of the ACLI are also in the business of accident and health insurance.

Mr. Chairman, you and the members of this Subcommittee are to be applauded for these timely hearings on an issue of extreme importance to employees, employers, the government and our industry—the need for a national policy on employee benefits and retirement income. These hearings are especially timely in light of the various tax reform proposals now under consideration.

Years ago, Congress recognized the need for adequate health care, life insurance and retirement income. As a result, it developed tax policies which encouraged employers and employees to use employee benefits to supplement the economic protection offered by public programs such as Social Security. Since then, America has gone on to build an employee benefits system that is the envy of the world, and we are extremely proud to be part of this system.

Now some people are suggesting that we abandon these tax incentives in favor of tax neutrality and simplification. Others, citing growing deficits, would sacrifice these incentives for the added tax revenues. Irrespective of the reason, the proposed change in tax policy is short-sighted and wrong. It is wrong socially, wrong economically and wrong for the welfare of our nation. It is short-sighted in that it ignores the success of past achievements and shuts its eyes to the very real needs of the future.

All evidence indicates the need for expansion—not contraction—of privately provided employee benefits. Without a supportive federal policy in this area how will our nation be able to:

prevent a retirement disaster in the early twenty-first century as the "baby boom" generation enters retirement age?

forestall a health care crisis as employers eliminate or drastically reduce health care benefits?

replace the essential protection currently available to millions of American workers covered under group-term life insurance plans?

Answers to these very real questions are not be found in the current tax reform proposals.

Mr. Chairman, we are grateful for the opportunity to detail in the following statement the key elements of what we believe to be a well-reasoned approach to providing retirement income. Since a sound national employee benefits policy is inextricably related to a national retirement policy, and because of the imminence of proposals to change the tax treatment of employee benefits, our comments will also address the implications of such proposals.

RETIREMENT INCOME POLICY

The ACLI supports a national retirement policy that has three basic objectives: to strengthen the private pension system, to encourage greater personal savings, and to ensure the fiscal soundness of the Social Security system. We believe in maintaining long-standing national social and tax policies directed to providing incentives for the private sector programs that, together with the underlying "net" of the Social Security system, provide an adequate and affordable level of retirement income for all Americans. Assurance of adequate retirement income generated primarily through private sector sources should be the continued objective of government policy.

We encourage adoption of a comprehensive and consistent national retirement policy that explicitly recognizes the "three-legged stool" of retirement income security. We hope that Congress will recognize that tax incentives have been and will continue to be the cornerstone of a viable private retirement system, that ERISA has to be revised in certain areas to encourage the continued growth of the private system, and that adding layers of administrative and compliance procedures will impede its health.

The nation's retirement system works. There may be a need for improvements and some fine tuning, but overall the joint venture between plan sponsors and government has resulted in ever increasing economic security for the majority of American workers.

Workers at all compensation levels are accruing benefit credits and earning vested rights. The continuing operation of over 800,000 employer-sponsored pension plans and the prospect of over two thirds of today's workers receiving benefits upon retirement indicates that the public policy objectives of ERISA generally are met. And contrary to critics' allegations that the private pension system favors principally high income groups, analysis has shown that the majority of the benefits are enjoyed by the middle class.

Data and analysis of tax burdens and tax benefits show that the pension system is equitable. Those earning between $20,000 and $50,000 per year paid 51.1 percent of all individual income taxes and received 56.6 percent of the pension tax benefit in 1982. Taxpayers earning less than $20,000 per year paid 16 percent of individual income taxes and received 17.4 percent of the pension tax benefit.

With regard to capital formation, pension funds currently play a major role in U.S. capital and credit markets. In 1983 alone, pension funds provided over $100 billion to these markets—about 19 percent of the total. While such investments are not the principal aim of pension plans, they play a vital role in our economy.

The impressive results noted above have been made possible by careful Congressional policy decisions to place primary reliance on private sector sources to assure adequacy of retirement income. A brief history of those decisions follows.

RETIREMENT POLICY IN RETROSPECT

In the early 1970's Congress had a choice—to expand the Social Security program to pay all workers a fully adequate retirement income or to encourage the private sector to be the primary source of adequate retirement income for workers. In enacting ERISA, Congress chose to continue the latter approach. Through responsible action by employers and the support of government-provided tax incentives, the private pension network has flourished and is delivering financial security to the majority of employees in this country.

Congress was aware that under a voluntary pension system, the cost of financing pension plans is an important factor in an employer's determining whether any particular retirement plan will be adopted. For this reason, Congress provided meaningful support to the private pension system through national tax policy. The asset accumulation and growth necessary to meet the private sector's responsibilities for its workers' retirement needs has placed the private pension system in a position to increase the overall level of savings, to aid the operation of our capital markets, and to improve the relative financial security of millions of workers.

ERISA did not put forth an explicit national retirement income policy nor did it establish a mechanism within the Executive branch or Congress for addressing futher policy considerations. In recent years retirement income policy has come to be viewed by some simply from a short-term perspective. For example, this year through its tax reform proposal, Treasury defines its current view of a retirement income policy. Treasury would make numerous changes in long-standing laws governing employee benefit plans—for example, one to their proposals would discourage employee savings by eliminating one popular form of retirement plan. The Treasury proposal is the latest example of a disturbing trend in recent pension legislation.

RECENT LEGISLATION

In 1982 and 1984, pension legislative proposals were driven not only by concerns over equity in the distribution of benefits, but also to greater degree by revenue concerns. Today, pension issues have become a central element in the national debate over major tax reform. Since the tax benefits accorded pensions are the largest single "tax expenditure", current tax reform debates are distorting Congress' focus on its long-standing commitment to the provision of privately funded pensions. And, unfortunately, sound design and employee needs are being over-shadowed by revenue needs. The demand for revenue from benefit plans that was evident in TEFRA and DEFRA has gained even greater momentum.

Tax incentives for pensions must be viewed as an investment in future economic security. The current tax laws which encourage retirement savings and capital accumulation are justified by the economic and social values served.

Additionally, recognition has to be given to the fact that qualified plans are a deferral, so that in the long run, the bulk of the income not currently taxed will ultimately be taxed upon distribution of the funds to the employee. Thus, a significant portion of the estimated $55 billion of tax that might be paid in 1986 if the tax laws covering pension plans were to be repealed will, in fact, be paid over the workers' lifetimes. There simply are no free rides. If pensions were not advance funded, there would be no "tax expenditures"—but neither would there be benefit security.

Whether to raise revenue to reduce federal deficits, or to offset tax rate reductions under the banner of tax reform, legislation cutting back on the current tax treatment of retirement plans and retirement savings seems a real possibility. Current Treasury proposals seem intended to reallocate incentives for retirement savings away from employer-sponsored plans to individual arrangements, again with little apparent concern for the consequences. Further, under Treasury's tax reform proposals, long-term accumulation under 401(k) plans would no longer be permitted.

THE NEED FOR A COMPREHENSIVE POLICY

A piecemeal, revenue-driven approach is wholly inappropriate for dealing with retirement income issues. Policymakers must address these issues in a comprehensive fashion. Employers need stable and consistent policy. When employers implement employee benefit plans they make a long-term commitment to benefit continuation. For the private employee benefit system to prosper, government must follow a consistent and coherent long-term approach and not continually shift policies.

A national retirement income policy would ensure this stability. We strongly believe that it is time to begin a full and open debate on the issues and to develop guidelines for such a policy.

We suggest a list of criteria for evaluating impact and desirability of all pension policy initiatives, including relevant legislation and regulation. As policies are analyzed, it is essential to view them in the light of other established policy positions. Since any particular policy alternative may meet several of the objectives while conflicting with others, a balancing of the relative importance of the various objectives may be necessary.

The objectives listed below take into consideration three general problems: pension benefit availability; system affordability and viability; and, finally, retirement issues as they relate to even broader national concerns. We believe that this strategic framework operates effectively and offer it to you for your consideraton, as follows:

1. Objectives related to benefit availability

Coverage: To provide retirement income to all career workers in an effective and reasonable fashion.

Adequacy: To provide retirement income which reasonably maintains the standard of living attained during one's working career.

Non-Discrimination: To provide retirement income on a non-discriminatory basis by developing an appropriate balance between individual needs for adequate benefits and individual rights for equitable benefits.

2. Objectives related to financial viability

Affordability: To ensure the existence of a nationally affordable retirement income program.

Financial soundness: To ensure financial soundness in the funding of all retirement income programs.

Efficiency: To maintain an efficient relationship among Social Security, pensions and individual savings.

Pension system viability: To improve the long-term viability of public and private pension plans in a cost-effective fashion while also minimizing current inefficiencies.

3. Objectives related to broader national concerns

Freedom of choice: To further freedom of choice and flexibility for individuals and employers.

Capital formation: To meet the nation's need for private sector capital through expansion of advance-funded retirement vehicles.

In response to other specific issues raised by this Subcommittee we believe a national retirement policy should address the following:

COVERAGE

Trends in pension coverage and participation have recently been the subject of criticism that pension coverage is not sufficiently widespread. These discussions of pension coverage often fail to address the key questions in this area, i.e.: (1) what percentage of families will receive private pension benefits upon retirement; and (2) what will be the size of the average pension benefit?

Since 1980, the Council has commissioned ICF Inc., a Washington, D.C. consulting firm, to undertake two studies of these important questions. The major findings of the 1984 study, which confirm the earlier, 1982 survey results, indicate that coverage and benefit receipt under private pension plans is widespread and will increase sharply and at a rate faster, on average, than wages. Specifically, the most recent ICF study shows that:

The percentage of families receiving pension benefits will increase rapidly in the future.—The study shows that by the time those individuals age 35–44 in 1979 reach age 67, approximately 82 percent of all married couples and 58 percent of unmarried individuals can expect to be receiving employer pension benefits from at least one spouse's covered employment. Benefit receipt at age 67 for the group 35–44 in 1979 will be 25 percent higher than benefit receipt for the group age 45–44 in 1979. Even these estimates understate the potential levels of benefit receipt because 10–15 percent of individuals who will still be working at age 67 and are nonetheless eligible for pension benefits were not counted in the study as receiving benefits.

Pension and Social Security Benefits combined will replace a significant amount of pre-retirement income.—The study calculated the expected replacement rates for families which were not working in retirement. As expected, replacement rates from Social Security and employer pensions will be higher for low income workers. Social Security and pension benefits will replace an average over 100 percent of pre-retirement income in the initial year of retirement for families who earned an average of less than $10,000 per year (in 1983 dollars) in their highest five years of income after age 56. Replacement rates fall below 60 percent for income groups above $20,000. The study also estimates that over 70 percent of those families with an average of less than $10,000 in pre-retirement earnings will receive retirement benefits that replace over 80 percent of their income. On the other hand, less than one-quarter of those with over $15,000 in pre-retirement income will have replacement rates larger than 80 percent.

Pension benefits will be widely distributed.—While a significant number of families can expect to receive income from private pension plans, the distribution of average pension benefits differs among family categories. For families with individuals age 35–44 in 1979, over 35 percent of married couples and 18 percent of unmarried individuals can expect to receive annual pension benefits above $7,500 (in 1983 dollars).

Vesting

In view of the substantial mobility of labor in this country, reasonable vesting is essential to prevent undue loss of pension benefits and to help provide adequate pensions for retired employees. While every effort should be made to improve the vesting of pensions by voluntary means, mandating more rapid vesting than is now required by ERISA would not, in our view, be the best solution to this problem.

It should be noted that the ERISA vesting formulas are minimum standards and pension plans frequently provide faster vesting than is required. Throughout their history, pension plans in the United States have continued to provide substantial improvements in the vested rights accorded to covered employees on a voluntary basis. The usual practice is for pension plans to be adopted with relatively modest features and then to be continually improved by providing more desirable features, including rapid vesting. Judging from past experiences, pension plans will continue to improve vesting through voluntary action.

In our view, the ERISA vesting standards represent a reasonable balance between the need to protect an employee's pension benefits and the need to keep the costs of pension plans within feasible limits. If, however, further improvement in the vesting practices of retirement plans is desired, it should be done voluntarily, not by imposing more rapid minimum vesting standards then those now set by ERISA. Mandating stricter minimum vesting standards (e.g., 5-year vesting) could cause the termination of existing plans and discourage the creation of new plans because of the increased costs of covering short-term employees. Moreover, adopting a 5-year requirement may not produce much in the way of additional vested benefits.

Defined Benefit versus Defined Contribution Plans

The continued existence of both defined benefit and defined contribution plans (including Section 401(k) arrangements) is in the best interests of a strong national retirement policy. Each type of plan has its advantages and attractions, depending on the particular type of employer, mix of employees, etc. For example, defined benefit plans offer employees the certainty of receiving a readily calculable amount of benefit. Further, such plans enable employers to offer substantial pension benefits to employees who begin participation under the plans at older ages.

Defined contribution plans, by contrast, are particularly attractive to some employers because annual costs per employee are predictable. This is especially important to small employers who typically must operate within strict cost constraints. Further, defined contribution plans are attractive to youner employees since, as participants, they have an account in which they directly participate. While defined contribution plans serve retirement purposes, they may serve capital accumulation needs as well, providing a resource against the economic crisis that would otherwise arise in the event of serious illness, the need to finance secondary education for one's children, or the purchase of a principal residence. We believe these needs are valid ones, and believe there is an important role to be played in a national retirement policy by plans that provide both for retirement and other contingencies.

We also support the continued availability of a variety of distribution options from plans (e.g. lump sum, life annuity, joint and survivor annuity, annuity certain, etc.). With regard to distribution options, Treasury has proposed to eliminate ten year forward averaging and to impose an excise tax on early distributions from pension plans. These proposals are consistent with Treasury's goal of discouraging distributions other than at retirement.

We also support the continued availability of a variety of distribution options from plans (e.g. lump sum, life annuity, joint and survivor annuity, annuity certain, etc.). With regard to distribution options, Treasury has proposed to eliminate ten year forward averaging and to impose an excise tax on early distributions from pension plans. These proposals are consistent with Treasury's goal of discouraging distributions other than at retirement.

In our view, Treasury's approach is ill-considered. While the annuity form of payout is clearly geared to a retirement mode, that does not mean that lump sum distributions do not address retirement purposes. Such lump sum distributions allow retirees the flexibility, for example, of purchasing a retirement home or investing in a small business or other venture which is beneficial to them and to the economy and is not inconsistent with the provision of retirement income throughout the retirement years. Indeed, the current treatment of lump sum distributions allows beneficiaries the flexibility of selecting alternative investment vehicles to provide retirement income.

Moreover, these are strong equitable arguments for retaining favorable tax treatment for pre-retirement distributions in economic crisis situations such as those noted with regard to defined contribution plans. We oppose the imposition of tax penalties in such situations. To penalize an employee facing true economic hardship who needs access to monies otherwise intended for retirement would be poor social policy.

The role of IRA's and private savings

Although the bulk of these comments have focused on employer-provided benefits, we wish to touch on the final element in the three part equation noted previously—the role of private savings. Without diminishing the importance of savings, we wish to point out that the United States, in recent decades, has had one of the lowest personal savings rates in the industrialized world. For example, in 1984, personal savings as a percentage of disposable personal income was an estimated 6.1 percent. I note this only to emphasize the unlikelihood that personal savings alone—even if greatly encouraged by liberalized IRA rules—could adequately provide retirement security for a significant portion of Americans. Moreover, individual retirement savings programs do not result in greater participation and wider coverage at all income levels nor afford fiduciary protection as do employer-sponsored plans. While our national policy should encourage personal savings, it should be recognized that personal savings alone cannot be expected to provide the extent of retirement coverage or the advantages and safeguards available under employer-provided retirement programs.

The ACLI believes that policy issues such as those discussed above should be at the center of the debate with regard to retirement income and employee benefit issues. Policymakers must address retirement issues in a comprehensive fashion, for without stability and certainty, employers will be unable to make long-term commitments to employee retirement security programs.

WELFARE BENEFITS

While we recognize that these hearings are primarily directed to a discussion of national retirement income policy, in view of the course of events—that is, the deficit, the current federal budget problems and the introduction by Treasury and others of tax reform proposals—we believe that this discussion might be well served by expanding our remarks to reflect the need for a national employee benefits policy.

For several decades, Congress has encouraged American business and labor to create and maintain employee benefit programs for the security of the nation's workers and their dependents. A key element in gathering employer support to establish these programs has been the tax treatment afforded employers and employees under current law.

The results have been impressive. A 1983 U.S. Labor Department survey, for example, found that 96 percent of all workers in medium and large firms were covered by group life insurance. At the end of 1982, about eight in 10 of all Americans under age 65 were covered by employer-sponsored group health policies.

In recent years, however, Congress has enacted major legislation affecting employee benefits which served to increase tax revenues but which worked adversely to the long-term goal of encouraging the continued expansion of private plans.

Now the private voluntary system for providing employee benefits is threatened by both major tax reform proposals and deficit reduction measures. Under both scenarios, there would be very adverse cutbacks in the current tax treatment of employee benefits which include health care benefits, group-term life insurance plan, and Section 401(k) plans. These reform proposals have been generated by the following:

> *Public perception that the tax code is overly complex and inequitable.* This perception has sparked demand for fundamental tax reform. Base broadening modified flat tax proposals would simplify the tax code, reduce the number of tax brackets and lower tax rates for most individuals. However, in order to broaden the base many exclusions, deductions, and credits would be eliminated.
>
> *High federal deficits* In the Treasury tax reform proposal, changes in the tax treatment of employee benefits would raise enough revenues to fund nearly 20 percent of the estimated cost of tax rate reductions. Pressure to reduce the federal deficit may push Congress not only towards spending cuts but also towards tax increases. Most items receiving favorable tax treatment will be reexamined. Employee benefits are an identified target.

Perceived inequities and abuses in the private employer sponsored employee benefits system.—Some have suggested that employee benefits mainly benefit the highly paid. However, in fact they are very much middle-class, working-class benefits with almost universal participation.

Concerns that the growth of employee benefits is eroding the taxable wage base.—Measures of tax-base erosion and the related "tax expenditures" associated with employee benefits may have been significantly overstated. Further, such revenue estimates ignore the social value of employee benefits.

If current proposed reform provisions are enacted, they could seriously undermine the foundation of economic security represented by retirement and employee benefits. Some of the consequences would be:

Adverse selection by some of those now covered, as young healthy workers who believe they do not need health insurance opt out of coverage once it is taxed, driving up the costs for those who remain.

Opting out of plans by lower income workers, who have the greatest need for coverage, but also the greatest need for cash.

Erosion of the incentive for retirement savings over the long term perhaps leaving many to face the last years of life in dramatically reduced circumstances.

Increased burdens on public health and welfare programs as people no longer covered under private programs begin to need assistance.

An expanded government role in the providing of health care and income assistance, leading ultimately to national health insurance and a more costly Social Security program.

The goals for reforming the tax code include simplicity, that fairness and neutrality. But the currently proposed reforms would reverse long-standing decisions of Congress without demonstrating why existing social policy should be changed. Congress might reasonably ask whether the social policy decisions made by Congress over the years are obsolete, whether the private sector decisions encouraged by the tax code are no longer in the public interest, and whether the benefits that might flow from tax reform clearly outweigh the negative social impacts of such proposals. We believe this inquiry should be part of the deliberations.

In the following discussion, we will address each of the major current employee benefit arrangements, outline the Treasury reform proposal relating to that benefit, and explain why we believe that reform proposal is ill-advised.

EMPLOYEE HEALTH CARE BENEFITS

Employer-provided health care benefits are of enormous value to the public and our industry has been highly successful in meeting the needs of American workers in this area. Existing federal tax incentives have encouraged that achievement.

The health insurance provided under employee benefit plans provides reimbursement for hospital, physician, dental and other medical expenses. We estimate that at the end of 1982, almost 65 million workers had group health coverage. Including spouses and children, approximately 162 million persons under age 65 were covered by one or more forms of private group health protection, either through our member companies or through other arrangements. That respresents 80% of the under 65 civilian population, and is a five fold increase since the end of World War II.

The Employee Benefit Research Institute ("EBRI"), in testimony before the Senate Finance Committee on July 26, 1984, stressed that current tax policy has increased needed coverage significantly for lower-income households, households with fragmented employment history, younger households and single person and single parent households. Figures for 1982, for example, show that 80% or more of covered workers earn less than $25,000. The encouragement of health benefit plans through tax incentives has been enormously successful. It has stimulated comprehensive coverage for most working Americans so that today, working people have come to regard employer-sponsored health protection as virtually an automatic feature of employment providing invaluable benefits.

Current law encourages health care benefit plans in two ways: (1) employers are allowed to deduct contributions made to an employee health benefit plan; and (2) employees are not required to include these amounts in their taxable incomes.

Treasury proposal—Treasury proposes to limit the amount an employer may contribute to an employee health care benefit plan without creating taxable income for employees. The limit is $70 per month for an individual and $175 per month for a family. Contributions by an employer in excess of these limits would be taxable to the employee. Treasury recognizes there is a national policy to promote health care services. It urges, however, that the caps are necessary to reduce "overconsumption" and produce more revenue.

Discussion.—Taxing health benefits is a bad idea for a variety of reasons, as follows:

The burden of the tax cap would fall unequally on workers depending upon where they work, their ages and their occupations.—The cap will discriminate against workers in areas where health care costs are relatively high—such as California and New York—where employers must pay twice as much or more for health care coverage as is paid in areas of relatively low health care costs—such as North Dakota. A recent HIAA study compard the impact of the proposed cap in various cities on the same comprehensive health plan. The increase in taxable income for workers covered by the plan (500 life group family coverage) was $1,946 in Los Angeles, $1,393 in New York City, $305 in Jackson, Mississippi and $135 in Fargo, North Dakota.

The tax would also discriminate against worker groups composed primarily of older workers whose health care costs are greater than those for younger workers. The average age of workers from industry to industry throughout the United States varies considerably. Plans covering workers with a higher average age are more costly and these workers would be subjected to higher taxes under the proposal.

Finally, the tax would fall disproportionately upon workers employed by small businesses and workers employed in high risk or hazardous occupations. Small businesses typically pay more for health care coverage because of higher administrative costs and greater variability of claim costs. High risk workers' costs are, obviously, higher because of the greater risks involved under their plans.

Imposing a tax on group health benefits could result in adverse selection as the young and healthy opt out of the plan, leaving older and less healthy members in the group to pay the cost of the plan. The resulting degeneration of plans would move the burden of providing health care to the government.—Current tax laws have long been recognized as playing a key role in the development of the privately financed benefits system. If the group insurance mechanism is to operate effectively, essentially all employees in a group must be covered. This is currently achieved by having the employer pay most or all of the premuim, with employees paying no tax on the employer's contribution. If the cost to employees is increased by having some or all of the employer's contribution added to their taxable income, employees will begin to drop out. The first to leave the plan will be the young and healthy (who are at relatively low risk) and other workers who need the money. As a result, premium costs will rise for the older and less healthy employees who retain coverage. The spiral of higher premiums, higher taxes and progressively fewer covered employees will have begun. The degeneration of plans will ultimately follow. It will be the lowest-income worker who will be hit first and hardest.

The tax cap would place essential preventive care in jeopardy as employers who want to avoid additional reporting requirements and employees who do not want additional taxable income will move towards limiting contributions to the amount which is not taxed.—To avoid exceeding the proposed cap, employer contributions would concentrate on purchases for hospital coverage, and preventive protection is likely to be reduced. Dental and vision care, mental health benefits and alcohol and drug abuse services may be dropped from health care benefit plans in order to keep the employer's contribution below the cap. These are sound and needed programs and the resulting reductions in coverage will adversely affect them.

The tax cap adds more complexity, not simplicity to the tax law. The complexity arises from the processes and difficulties involved in computing the per employee costs around the country, reporting costs to employees, including the cost in the employees' tax return and auditing all of the above.—If the tax cap is adopted, employers will have additional costs because of the requirement that they report the taxable amount for each participant in the plan. Isolating health care costs around the country which are subject to the computation will require a major effort. Building systems that will do this work will be complicated and costly, especially for small businesses.

The tax cap would not reduce overconsumption of health care.—The Treasury asserts that the tax cap would be a significant tool to "reduce overconsumption of health care services". If there is "overconsumption" this is not the way to address it. Assuredly, there has been inflation in health care costs. The cost of health care is a problem for employers and employees regardless of whether a tax cap is imposed. It is a problem not just for private insurance programs, but for Medicare, Medicaid and people who have no insurance at all. Many employers are already making changes to alleviate the cost of the health care plans they now provide. This is going on without any changes in the tax system.

Traditional insurance plans are being modified to increase deductibles and coinsurance requirements so that individual employees have a greater interest in controlling their use of health care facilities. In addition, preadmission testing and second opinions before surgery are offered or required to reduce hospital stays and eliminate unnecessary surgery. Health care systems are changing with the growth of fixed fee Health Maintenance Organization, which emphasize preventive health care and Preferred Provider Organizations, which offer guaranteed rates in exchange for guaranteed volumes of business. Hospital costs have been the major factor in health care inflation but this problem is being addressed directly by employers, insureds and hospitals. The government itself increasingly regulates health care growth and spending by hospital cost control programs, capital planning and mandatory utilization review.

The net result has been to reduce significantly excessive health care cost inflation. For the twelve months ending September 1984, health care cost inflation was 1.5 times the CPI, down from 1.7 times in the twelve months ending December 1983 and 2.8 times in the twelve months ending December 1982. The problem of inflation in health care costs should be addressed and is being addressed through changes in the way the health care system works, not through an additional tax on workers.

Conclusion. The present tax treatment of employer-provided group health insurance has contributed significantly to a sound health care system for American workers. Health care cost problems are being addressed directly through changes in the health care system. The tax treatment of workers should be left alone and the tax cap should be rejected.

EMPLOYER GROUP LIFE INSURANCE

The purpose served by group life insurance is to replace the income lost through the occurrence of an employee's untimely death. Employer-sponsored group life insurance plans are the best way of accomplishing this purpose. By promising such replacement, group life insurance serves to improve the morale and productivity of employees. Corporate-sponsored group life insurance is now an integral part of our economic way of life.

The growth of group life insurance has been prodigious since its introduction in 1911. At the end of 1983, group life insurance in force through employers was $1.7 trillion and more than one-half million employers of all sizes had purchased life insurance for their employees. In a 1983 survey conducted among medium and large employers by the U.S. Department of Labor, 96 percent of all employees of these firms were reported to be covered by group life insurance. And, while the numbers are not quite as dramatic, a 1983 survey conducted by the Life Insurance Marketing and Research Association ("LIMRA") indicated that among employers of 3-50 employees, more than 80% had purchased a group life insurance policy as part of a package of employee benefits. Group life insurance is a near-universal employee benefit in the United States.

The amounts of life insurance provided through employer-sponsored plans is typically related to the individual employee's salary. According to a recent survey conducted by Hewitt Associates among major U.S employers, in 1983 approximately 73 percent of all such employees had purchased group life insurance schedules that were salary-related, with the most popular salary multiple being 1-times (32% of the employers) and 2-times (22% of the employers). In a survey conducted by the ACLI in April, 1981, more than 50 percent of the total claim payments made under group life insurance policies were in amounts exceeding $25,000 per beneficiary.

Employer-provided group life insurance also reflects the changing nature of the American workforce. It is well-known that increasing percentages of women are entering employment. According to a recent ACLI publication, nearly 52 percent of all married women were in the workforce in 1982, up from 41 percent in 1971. An ACLI study of trends in death benefit payments under group life insurance policies indicated that in April, 1981 almost 20 percent of the deaths were female employees, representing a significant increase over the 13 percent reported in October, 1966.

In recent years, the attractiveness of group life insurance has led an increasing number of employers to extend such insurance beyond the working years of their employees. In a survey conducted by The Conference Board in 1979, more than two-thirds of a sample of large and small employers indicated that they were continuing some group life insurance protection into retirement. A later survey conducted in 1983 by Hewitt Associates indicated that among large employers the percentage exceeded 80 percent.

And, as a growing number of states change their group insurance laws, employers are extending their group life insurance plans to include spouses and dependent children. Where now permitted, the aforementioned Conference Board survey indicated that 25 percent of large and small employers were providing some dependent group life insurance.

As shown by these statistics, employer-provided group life insurance has grown rapidly in the 73 years since it first became available. There are broad social aspects to the growth of group life insurance. One great service of group insurance is that it extends life insurance coverage to a large number of persons with little or no other life insurance. And, group life insurance also extends protection to persons who cannot qualify for individual life insurance either because of physical problems or hazardous occupations. The proportion of employed persons who are uninsurable for individual policies has been variously estimated between 5 and 10 percent. It is only through group underwriting that private life insurance can provide protection for these persons, and it is advantageous both to the individual and to society that insurance be made available to them.

Under current law, employers are allowed to deduct premiums paid for group-term life insurance provided to employees. Employees may exclude from their income the cost of the first $50,000 of employer-provided group-term life insurance.

Treasury proposal.—Treasury would repeal the exclusion related to the first $50,000 of coverage. Treasury asserts that this is warranted because the exclusion produces inequities between taxpayers, favors taxpayers in high brackets and encourages overconsumption of life insurance.

Discussion. In 1982 under the Tax Equity and Fiscal Responsibility Act ("TEFRA") and again in 1984 under the Deficit Reduction Act ("DEFRA"), Congress examined the group-term life insurance exclusion. Antidiscrimination rules were added in 1982. In 1984, these rules were made applicable to retirees who also became subject to the $50,000 limitation. In making these changes while leaving the $50,000 exclusion intact, Congress reaffirmed that the $50,000 exclusion made sense and should be preserved. Arguments in favor of continuing this exclusion include the following:

Group-term life insurance is a nondiscriminatory method of providing life insurance protection. It is available to employees on a nondiscriminatory basis under rules which assure that there is no preference for higher paid employees.—A reason suggested for taxing employee benefits has been that in some cases they are available only to higher salaried or key employees. This is not the case with group-term life insurance. Congress covered this point in TEFRA. As the number of employer-sponsored group-term life insurance plans increased, there was concern that the tax incentives available under these plans could be used to discriminate in favor of highly compensated employees. As a result of the changes made in TEFRA, the $50,000 exclusion is not available to key employees who are unfairly benefited by a plan with respect to eligibility, benefit type, or benefit amount. Additional nondiscrimination provisions were enacted by Congress in 1984 in DEFRA, so that the concern regarding possible abuse of the tax incentives provided for group-term life insurance has already been met by Congress.

Group life insurance is not "overconsumed". The average amount of employer-provided group-term life insurance per employee is approximately $26,000. This modest amount of coverage is equivalent to continuing the average worker's salary for less than two years. This is not a "windfall"—but rather a modicum of financial assistance—to the worker's spouse and children.—There is no overconsumption of group life insurance. Currently, an estimated 90% of covered employees receive less than $50,000 of group life coverage. The average amount of employer-provided group life insurance per employee is about $26,000. It is hard to imagine that this modest coverage—equivalent to continuing an average worker's salary for less than two years—will replace a worker's lifetime income much less provide a windfall to a surviving spouse or child.

Group life insurance affords needed protection for workers who cannot medically qualify for individual life insurance and for many workers who have no other form of individual life insurance.—For many workers, group life insurance is their only form of life insurance protection. Among these are persons who cannot qualify for individual life insurance either because of physical problems or hazardous occupations. It is only through group underwriting that private insurance can provide protection for these persons. Beyond this, group life insurance is attractive because of its low cost. Without it many workers would have no protection.

The new tax would discourage workers from continuing their group life insurance coverage and weaken employer-provided plans. The loss of needed coverage would lead to more demands on Social Security and other government programs to provide the benefits.—If employees must pay taxes to maintain their group life insurance, many looking to short-term cash needs may terminate their insurance. Terminations by younger and healthy workers will increase costs for remaining workers. This will bring a weakening of employer plans so carefully put together by labor and management. Ultimately if insurance is not available upon an employee's death, non-working survivors will require care and support from other sources—most likely increased Social Security or other government programs. In all likelihood, the long-term costs of the benefits the government will be called upon to provide will far offset the revenue the Treasury might gain from elimination of this modest exclusion.

The rationale which persuaded Treasury to leave the fundamental tax rules for qualified penson plans intact should apply to employer-provided group life insurance.—The Treasury has appropriately agreed that the basic tax treatment afforded qualified pension plans should not be disturbed. These plans—which are subject to antidiscrimination requirements—provide protection for employees and their families in later years. It has been said that they afford financial protection if the employee "lives very long". The same considerations should apply in the case of employer-provided group life insurance. This coverage—which is also subject to antidiscrimination rules—provides protection for an employee's family if the employee "dies too soon". There is room in sound tax policy for retaining the present encouragement for workers to protect their families in either event.

Conclusion.—The $50,000 exclusion of employer-provided group life insurance should be retained.

Section 401(k) plans

Section 401(k) plans, also called "CODA's" (cash-or-deferred arrangements), were first permitted by the Revenue Act of 1978. Since 1982, these plans have rapidly become an important element in retirement savings. Under a Section 401(k) plan, employees have the option of receiving direct cash payments or of having their employers contribute all or a matching portion of those payments to the plan. Amounts contributed to the plan are not includible in the employee's gross income at the time of contribution provided specific requirements are met.

Treasury Proposal.—The Treasury has proposed that the tax provisions authorizing Section 401(k) plans be repealed with respect to contributions to the plan on or after January 1, 1986.

Discussion.—We believe the Treasury proposal is ill-advised for the following reasons:

Treasury's concerns that the Section 401(k) limitations are more liberal than those applying to IRA's is misplaced.—In proposing to increase the limits on contributions to IRA's and to eliminate 401(k) plans, Treasury is selecting IRA's as the appropriate vehicle for the receipt of deductible retirement plan contributions by individuals to the exclusion of their existing plans. This would be a serious mistake and shortsighted tax policy. The use of effective group arrangements, such as Section 401(k) plans, for the provision of retirement benefits should also be encouraged and should coexist with IRA's.

Indeed, while Section 401(k) plans have favorable characteristics and attributes shared by IRA's, a 1983 study by Hewitt Associates found such plans to be a more potent tool for individual retirement savings than IRA's. That study's results demonstrated that only 16.9 percent of the workforce had established IRA's and that usage was highest among the higher paid employees. Only 11 percent of workers earning less than $20,000 established IRA's compared with 58 percent of those earning more than $50,000. In contrast, among some 250 corporate 401(k) plans surveyed, the average employee participation rate was 81 percent.

Section 401(k) plans distribute pension benefits across income classes and must meet very strict nondiscrimination requirements. These plans are subject to audit to assure that all requirements are observed.—401(k) plans must satisfy special and rigorous nondiscriminatory requirements. The special 401(k) rules prohibit discrimination in favor of "highly compensated employees" with regard to deferred amounts. Highly compensated employees may not contribute more than an allowable percentage of their compensation to a 401(k) plan. This percentage is directly influenced by the extent of participation in the plan by rank and file employees. These plans are, unlike IRA's, subject to audit to assure that all requirements are observed. It is, therefore, in the interest of the highly compensated employees for the employer to encourage and sustain broad and meaningful plan participation on the part of rank and file employees.

The amounts involved under Section 401(k) plans do not escape tax. Taxes are simply deferred until the employee retires and receives the income. The Employee Benefit Research Institute has found that 72% of the tax deferred by active employees is eventually repaid in retirement.

Employer-sponsored retirement plans are a sound and cost effective alternative to individual programs and should be retained. It is generally recognized that employer-sponsored retirement plans are a sound way of providing for retirement. For example, the "Final Report by the President's Commission on Pension Policy," 1981, recognized that "a major objective of retirement income policy should be to insure that today's retirees and tomorrow's elderly are able to maintain a reasonable standard of living in their later years." In view of this, the President's Commission recommended the expansion of the role of employer-provided deferred compensation plans. To the extent the retirement needs of employees can be met by employer-sponsored qualified plans, it will not be necessary for the government to provide additional aid to retirees.

Employer-sponsored retirement plans encourage capital formation. Private savings and capital formation should be encouraged. One way this goal can be achieved more effectively by Congress is through encouragement of broad-based retirement plans maintained by employers to provide income security for great numbers of employees. Capital formation achieved through employer-sponsored plans will benefit the economy while at the same time employees will obtain the benefit of participation in employee benefit plans such as Section 401(k) plans.

Conclusion.—The current tax provision authorizing Section 401(k) plans should be continued.

CONCLUSION

As our testimony today has shown, the private sector has accomplished a great deal in providing socially valuable benefits to American workers and their families. The job, however, is not done—there are still gaps in coverage. The private sector is anxious to close these gaps, but it needs help. Tax incentives have worked in the past, but they must be continued and, where appropriate, expanded, to provide the impetus necessary to complete the job.

I appreciate the opportunity to appear before you today to express the views of the ACLI and HIAA on this very important subject. If you have any questions I would be happy to answer them.

Mr. CLAY. Thank you. Next.

Mr. STONE. Thank you, Mr. Chairman. My name is Bob Stone; I am an attorney with IBM, and I appear here today as chairman of the ERISA Industry Committee, known as ERIC.

ERIC has been actively involved in ERISA matters since 1975; I have been privileged to serve on its board since shortly thereafter, and we have worked closely with the staff and members of this committee in the past, and look forward to doing so in the future.

We are delighted that you have called these hearings, and have asked for an examination of a national retirement policy and a view of employee benefits in general. We are even happier to see this committee asserting its continued active interest in this area.

Tax reform, tax simplicity, and tax fairness are very worthy goals, as is deficit reduction. The problem we see is that pensions and benefits are not loopholes; they are not fringes. They should not be automatically jettisoned in favor of tax reform or tax simplicity. They are a private safety net for the vast majority of working Americans and their families.

According to figures developed for Senate Finance Committee Chairman Bob Packwood, 70 percent of tax filers benefit from tax-favored employee benefits, compared to only 25 percent of tax filers who benefit from home mortgage deductions. Employer-sponsored plans are very effective, very efficient, and a key point, which I could not stress too much, they provide flexibility to meet the varied needs of different groups of workers in different industries at different stages in a worker's life. They offer the security found in numbers; both the cost effectiveness of group risk sharing, and the protection through antidiscrimination standards to ensure that all individuals at all income levels benefit.

In considering pension policy or tax reform, it is important to understand that access does not automatically equal equity. As Mr. Lebed pointed out, only 17 percent of those eligible to put their money in IRA's have done so. Group plans, on the other hand, like 401(k) plans, show consistently higher participation among eligible employees at middle and lower income levels.

Another point I wish to make: We often hear cited a figure amongst the tax reformers that benefits now consume 30 percent of compensation. It is important to understand that less than one third of that figure, 10 percent, is awarded in the form of tax-favored benefits, and, on half of that, taxes are only deferred and will be paid at a later date. We have a chart which accompanies our submitted testimony, and it shows that the remaining parts of the so-called benefits portion of compensation are consumed by fully-taxable benefits, or are required by law, such as the payments for Social Security taxes.

Over the past several decades, this Nation has developed a carefully-structured retirement policy for workers and their families. This policy consists of Social Security, pensions, and savings. This committee has been instrumental in the development of that policy, and can take much of the credit for the fact the system is amazingly successful. Within a few short decades, the voluntary private pension system, encouraged to a great extent by the enactment of ERISA, has covered over one-half of the entire workforce. This is not just for the executive class. Seventy-one percent of those covered in 1982 earned less than $25,000 a year; whereas less than 3 percent of that number earned in excess of $50,000.

Among recent retirees, 56 percent of couples and 42 percent of individuals are actually receiving retirement benefits. More have asset income. If Government policy stays the same as it is now, over 70 percent of all 25- to 34-year-olds will receive a pension benefit when they retire; not a bad record in a few short decades.

We believe it is important to recognize that tax-favored group pension and savings plans are already closely regulated; more regulation does not encourage their continued formation. Second, flexibility is the key. We must recognize that there are needs for different plans among different types of employers. A mature, successful, profitable company can afford a much greater spectrum of employee benefits than the start-up venture capitalist who is trying to make it on a shoestring.

We must recognize that in certain industries the age population of the average employee is skewed to one end of the scale; in other industries, to the opposite end of the scale. We must avoid any sort of disincentives in the interest of tax reform which are built into the system which penalize and discourage the formation of employee benefits.

In studying all of the issues related to retirement security, including so-called horizontal equity, this committee should take the lead in convincing Congress not to reduce the economic security of workers under current plans which already protect the majority of the American population, and from that point, we should work toward continuing to improve the system we have. Thank you very much.

[Prepared statement of Robert S. Stone follows:]

PREPARED STATEMENT OF ROBERT S. STONE (SENIOR COUNSEL, IBM), CHAIRMAN, THE ERISA INDUSTRY COMMITTEE (ERIC)

Mr name is Robert S. Stone. I am Senior Corporate Counsel with the International Business Machines Corporation (IBM) and Chairman of the ERISA Industry Committee—known as ERIC—on whose behalf I am appearing today.

ERIC represents over one hundred of the nation's largest employers who administer benefit and retirement security programs for some 8½ million workers and retirees. Our members come from all major industries, including communications, steel, retailing, automobile, high technology, service, banking, food marketing, oil and chemical, insurance and manufacturing and have facilities in every state of the Union. All ERIC member companies offer comprehensive employee benefit programs to their employees.

We are pleased this committee has called hearings on employee benefits and national retirement policy. This committee has a long history of interest in pensions and other employee benefits.

In recent years employee benefit plan sponsors have been subjected to repeated changes in the law driven by revenue concerns and anecdotal complaints. More changes have been suggested in recent tax reform proposals. Many of these proposals represent major changes in policy that could easily be overlooked in the general debate on tax reform or budget reduction. We are pleased, therefore, to join with you now in consideration of national policy for employee benefits and retirement income.

First, in response to the questions raised in the press release announcing these hearings, let me make some critical points about employer-sponsored benefit plans and their importance to workers and to national policy.

Tax reform, tax simplicity, and tax fairness are worthy goals, as is deficit reduction. Pension and benefit programs, however, are not "loopholes" on the "fringes" of an individual's life. They are a private sector safety net for the vast majority of working Americans and their families.

Continued tax-favored treatment of employer-sponsored plans underlies continued economic security for workers. Moreover, changes in employer-sponsored benefits such as those included in the Treasury tax proposal would have devastating consequences on individuals without contributing to overall goals of base broadening and rate reduction. While Treasury plan pension proposals are virtually revenue neutral, they would severely restrict the flexibility of the current system in meeting individual needs.

Taxes on employee benefits raise revenue only by imposing new taxes on vast numbers of Americans. A lower *rate* does not necessarily mean lower *taxes* if a worker's take home pay is reduced because we are taxing his or her employer-sponsored benefits as if they were income.

The effects of these new taxes on benefits would be most dramatic on middle and lower income workers. According to figures developed for Senate Finance Committee Chairman Bob Packwood, 70% of tax filers benefit from tax-favored employee benefits. This compares to 25% of tax filers who benefit from home mortgage deductions.

Employer-sponsored plans are effective and efficient. They provide the flexibility needed to meet the varied needs of workers in different industries, different industries and at different stages in a worker's life.

They offer the security found in numbers: both the cost effectiveness of group risk-sharing and the protection of antidiscrimination standards to ensure that individuals at all income levels benefit.

It is important to understand that access does not equal equity. Individual arrangements like IRAs, for example, are dependent both upon the individual's ability to set aside income and to select the right investment. Only 17% of those *eligible* to have IRAs do so. Group plans like 401(k)s show consistently higher participation among eligible employees at middle and lower incomes than do IRAs.

In addition, employer plans are a "good deal" for the government. We often hear cited a figure that benefits now consume about 30% of compensation. However, it is important to understand that only about 10% of compensation is awarded in the form of *tax-favored* benefits and on half of that taxes are only deferred and will be paid at a later date. As the chart accompanying this testimony shows, the remaining parts of this figure are consumed by fully taxable benefits such as vacations or legally required benefits such as social security taxes.

Disruption of current private sector employer protections against sickness, death, extraordinary expenses, and loss of wage income in retirement would inevitably lead to public demand for government programs to replace lost benefits where the government would have to assume the full cost of providing lost benefits instead of sharing that cost with the private sector.

Moreover, pre-funded benefit programs provide essential investment capital for the growth of the U.S. economy. Private and public sector pension funds now equal nearly one trillion dollars and are fast becoming primary source of investment capital in this nation.

Now I would like to address more directly some of the additional questions raised in your press release.

Over the past several decades this nation has developed a carefully structured retirement policy for workers and their families. That policy consists of social security, pensions, and savings. Recently it added SSI as income maintenance for the aged poor, including those who have never had an attachment to the workforce.

This system is amazingly successful. Social security provides old age benefits of $6,580 a year for a new retiree with average earnings. It pays benefits to 36 million retired or disable workers and survivors. Within a few short decades, the voluntary private pension system has covered over one-half of the entire workforce. Seventy-one percent of those covered in 1982 earned less than $25,000 and less than 3% earned over $50,000.[*] Among recent retirees 56% of couples and 42% of individuals are actually receiving pension benefits. More have asset income.[1] If government policy stays the same, over 70% of all 25–34 year olds will receive a pension benefit when they retire:[2]

Maintaining the strength of the current system is critical. America's population is rapidly aging. Today 16% of our population is over 60. But by the year 2020, 25% of our population will be over 60.[3] These people are a potent political force which will have the ability to demand the resources from the government to take care of them in retirement if they are otherwise provided for today by probate pensions and individual savings. This challenge is heightened by increases in longevity which will require increased income for retirement years and substantial additional medical costs. Neither social security nor private pensions nor individual savings can alone fill these needs. Together they can. Indeed, they must.

In attempting to provide adequate protections for workers and their families, we believe it is important to recognize the following points:

1. Tax-favored group pension and savings plans are already severely restricted under the law. They must meet non-discrimination standards. They are also limited regarding the amount that can be contributed and, in the case of defined benefit plans, regarding the amounts that can be distributed. We do not believe national retirement policy is enhanced by further restricting funding for pensions under employer plans as some reform proposals would do.

2. ERIC strongly encourages and supports defined benefit pension plans as a primary means of providing a secure retirement income since the employer assumes the burden and risk of benefit payment. We also support defined contribution plans and capital accumulation plans as vital components of retirement. These plans are a more appropriate retirement vehicle for some companies, and, where they are in combination with defined benefit plans they provide additional protection against unforeseen needs and inflation. Profit sharing and thrift plans also provide options for middle and lower income workers to meet important life needs, providing economic security in working years that will carry over into retirement.

Put another way, while young workers need to save for retirement, they are more likely to save for other major needs or to protect themselves against unforeseen expenses such as illness or unemployment. If young workers are encouraged by an employee plan to save they are more likely to do so. The savings they accumulate turn into capital for retirement later in life.

3. Since social security provides a high income replacement to individuals with low wages and a much lower income replacement to middle and higher income workers, we believe coordination of private plan benefits with social security (integration) is essential to providing an adequate retirement income to all workers.

4. Just as flexibility in plan design is important, so is flexibility in retirement age. The Treasury proposal to penalize all who retire before age 59½ or after age 70½ is unrealistic, and would vastly diminish the retirement security of many workers.

5. In studying issues related to so-called "horizontal equity", Congress should take care not to reduce the economic security of workers under current plans which already protect a majority of the American population. Instead, Congress has the

---

[*] 1984 EBRI Study.

[1] 1982 New Beneficiary Survey SSA.

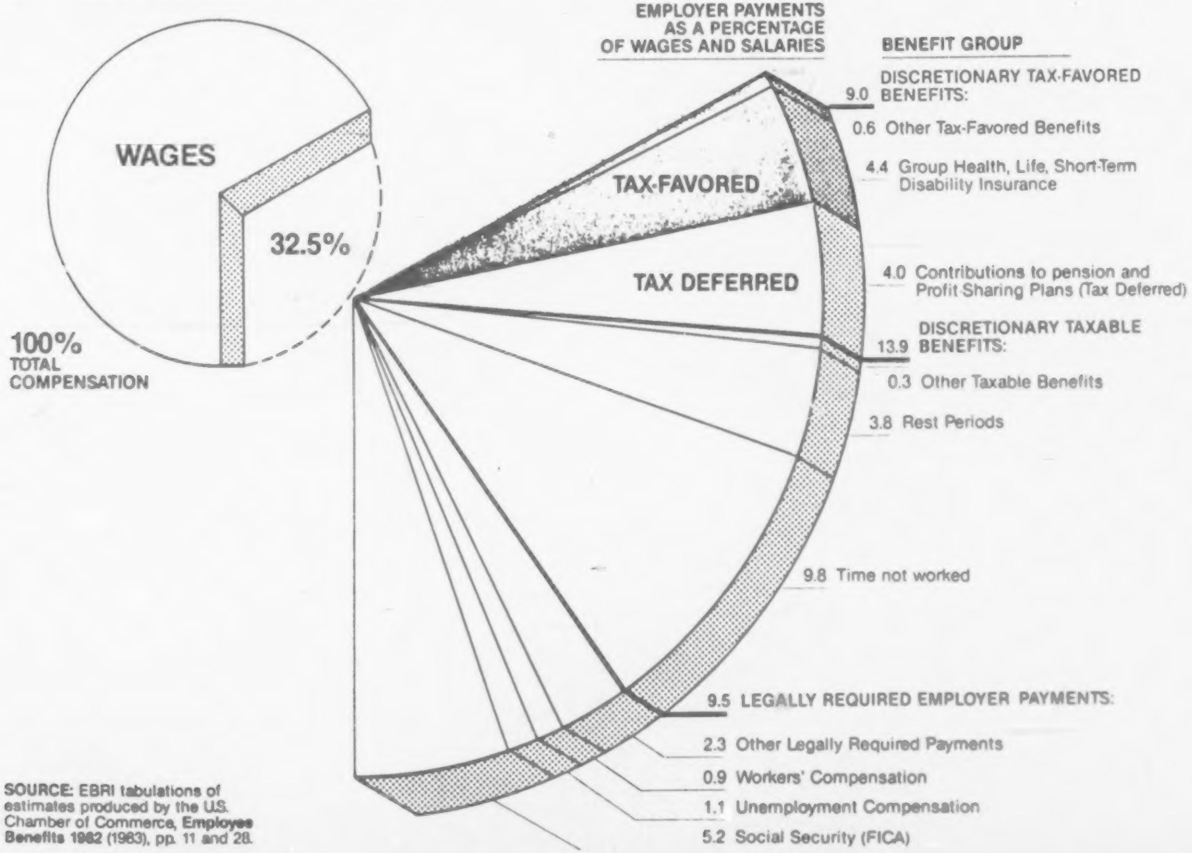
[2] 1984 EBRI Study.

[3] CRS Study.

option of extending tax-favored treatment to those workers outside the scope of employer-sponsored plans.

Finally, we would emphasize that we have a strong foundation in the retirement and benefits policy now in place, and we would note that tax-favored employer-sponsored benefits play a vital, but balanced, role in our national benefits policy in cooperation with government and individual programs. We urge your renewed support of this important partnership.

COMPOSITION OF EMPLOYEE BENEFITS BY BENEFIT GROUP 1983



SOURCE: EBRI tabulations of estimates produced by the U.S. Chamber of Commerce, **Employee Benefits 1982** (1983), pp. 11 and 28.

Mr. CLAY. Thank you. Mr. Cowles.

Mr. COWLES. Thank you, Mr. Chairman. My name is George Cowles, I am a senior vice president of Bankers Trust Co., and I also serve as chairman of the Employee Benefit Services Committee of the American Bankers Association.

I am speaking today on behalf of banks as employers of some 1.5 million employees, as well as banks as fiduciaries managing more than $335 billion in employee benefit funds. It is clear then that banks are vitally interested in our Nation's retirement plans.

The American Bankers Association has often called upon the Federal Government to adopt a coherent national retirement income policy. As our Nation's population grows older and the Government's needs for budget restraint become more acute, the need for an overall policy becomes increasingly more urgent. Such a policy, once formulated, should provide a yardstick against which legislative and regulatory initiatives affecting retirement plans would be measured. I, for one, don't believe there is a well-articulated national retirement income policy, and I am reminded of a quote of Lewis Carroll's: "If you don't know where you are going, any road will take you there."

Providing for retirement has often been analogized—and it has been several times this morning—to the three-legged stool. Social Security; employer-provided pensions; and individual savings. I don't think that anybody disputes that Social Security was designed to provide and, in fact, does provide only a basic floor of benefits. It is common for banks to target retirement income from all sources for career employees in a range of 65 percent of final pay for employees at the higher end of the salary scale to 80 percent of final pay for those in lower salary ranges.

Without strong encouragement to save, many employees, especially those at lower salary levels, will not begin to save until far along in their work lives. Employer plans make it convenient and less painful through payroll deduction. They provide added incentive through matching contributions and tax deferral.

A shortcoming, at least potentially, is that employees, no matter how thrifty, may outlive their savings. Defined benefit plans provide a constant benefit from date of retirement through the end of the life of the retiree; you can't outlive the benefit. The three-legged stool needs the continued strong and active encouragement from Government.

With respect to faster vesting, we don't believe it should be mandated without weighing carefully the increased costs entailed. Not only the cost to fund the benefit, but also the administrative and recordkeeping costs in maintaining the funds and records of terminated, vested employees until they reach retirement age.

The ABA has objected to mandatory portability of benefits primarily because we have never seen a scheme which we thought was workable. The IRA for some has become a de facto portability vehicle. Recognizing the significant advantages to employees and employers, it may be that portability's time has come. Any proposal for portability, however, should, at a minimum, address the following: the effect on the continued viability of employer plans; the valuation of benefits and reasonableness of interest rate assumptions; the treatment of cash outs; the potential for a private sector solution; and optional participation on the part of a plan sponsor.

If coverage is to be expanded, which seems to be a universally-desirable goal, Government should, at a minimum, retain current incentives and explore others to further encourage employers without plans to establish one. It should be recognized that frequent changes requiring continuous plan amendments and increasingly stringent and detailed requirements present cumulative disincentives to establishing and maintaining plans.

Our association fears that any policy articulated by the Congress will not endure very long unless some ongoing, independent body is charged with overseeing and implementing that policy. For that reason, we have recommended an independent body whose charter should come from the Congress, a charter which would include not only the oversight and protection of the National Retirement Income Policy, but the protection of rights of participants and beneficiaries and protection of the private retirement system as well. In our written submission we have more fully discussed this concept.

We are pleased to have been able to testify this morning, and we look forward to working with the committee and the staff in the future. Thank you.

[Prepared statement of George Cowles follows:]

PREPARED STATEMENT OF GEORGE W. COWLES ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of the Subcommittee I am George W. Cowles, Senior Vice President, Bankers Trust Company, New York. I serve as Chairman of the Employee Benefit Services Committee of the American Bankers Association.

I am speaking today on behalf of banks as employers of some 1.5 million employees as well as banks as fiduciaries of employee benefit plans. Bank trust departments manage more than $335 billion in employee benefit fund assets. In addition, banks serve as master trustee or custodian for additional hundreds of billions of dollars of employee plan assets. It is clear, then that banks are vitally interested in our nation's retirement plans.

The American Bankers Association has often called upon the federal government to adopt a coherent national retirement income policy. As our nation's population grows older and the government's need for budget restraint becomes more acute the need for an overall policy becomes increasingly more urgent. Such a policy once formulated should provide a yardstick against which legislative and regulatory initiatives affecting retirement plans would be measured.

As the Subcommittee begins its study of retirement policy it makes sense to review some of the considerations employers weigh in designing and providing programs for their employees. Employers hope to provide employees with some measure of security. By that I mean protection against risks which employees are least likely to be able to provide themselves.

During employees' working lives these risks include

loss of life; employers generally provide some form of life insurance to provide for the worker's survivors.

loss of health or ability to work; employers provide some form of health and disability insurance to provide for the continued security of the employees and their dependents.

Finally, at the end of employees' working lives, employers attempt to provide workers with a means to continue living out their lives in a self-sufficient manner.

Providing for retirement has often been analogized to a three-legged stool. Each leg is necessary for the stool will not stand with only two. The three legs of the retirement stool are:

Social Security, which government assures will provide a minimum floor of income protection for retired workers

Employer pensions, amounts set aside by employers to provide for workers during their retirement

Individual savings, funds set aside by workers themselves.

It is common for banks to target retirement income from all sources for career employees in a range of 65% of final pay, for employees at the higher end of the salary scale, to 80% of final pay for those in the lower salary ranges. These are broad goals for employees who spend thirty years or so, their entire careers, with a bank.

Social Security provides the floor of benefits. Political and economic pressures to increase Social Security benefits because of reliance upon that system as the major retirement income provider are relieved to the extent that retirees can look to savings and employer pensions. Given that, let me describe how we see the further interrelationship of savings and employer pensions. In speaking of savings we include IRAs and employer sponsored savings plans with other savings and investments that workers have accumulated independently.

For many employees, especially at the lower salary levels, independent savings or investments, even IRAs, are seen as less important and often not affordable during the period they are raising and educating children. Without strong encouragement to save, such as through employer plans, many workers will not begin to save until far along in their work lives. Employer plans make it convenient and less painful through payroll deduction; they provide added incentive through matching contributions and tax deferral.

A shortcoming, at least potentially, is that employees no matter how thrifty, might outlive their savings. Guarding against that eventuality by providing a benefit which retirees cannot outlive are employer provided defined benefit plans. Defined benefit plans provide a constant benefit from date of retirement through the end of the life of the retiree and, unless elected against, under a joint and survivor benefit, the life of the retiree's spouse as well. For this reason as much if not more than any other, defined benefit plans can and should continue to occupy and important place in the overall retirement scheme and should be fostered and encouraged.

The three legged stool needs the continued strong and active encouragement from government. All three legs are needed if retired workers are to be assured their individual economic independence and financial security. Furthermore, a strong pension policy favoring the private pension system as a complement to Social Security will decrease the likelihood of dependence upon Social Security as the sole source of retirement income and greatly decrease older American's dependence on other government subsistence programs.

Banking recognizes that with strong governmental encouragement comes regulation and restriction. However, extreme care should be taken in imposing regulation lest private creativity and adaptability be stifled to such a degree that the regulation becomes self defeating.

Benefit plans should not be permitted to discriminate and some reasonable limitation on government favored benefits probably in relation to compensation, may be warranted. But even in this area special care must be taken.

Let us point to one example. The combined limitations under IRC Section 415 were ostensibly designed to cap the benefits of highly paid executives under qualified plans. In fact, since the advent of Section 401(k) and the reduction of the limit to 1.2, lower paid individuals have been affected adversely. Because Section 401(k) contributions by the employee are counted as "employer" contributions (even though they are in practice the deferral of salary), limits can be reached quite easily for lower paid employees.

When the cap is reached an employee must either change his/her pre-tax contribution to a post tax contribution or forego a portion of the employer's profit sharing/thrift contribution to that plan.

Moreover, because of the combined limitation, the employer's pension plan accruals for those younger employees would have to be reduced as well. The specific amount is impacted by length of service and age.

Vesting

The work force today is much more mobile than in past generations. More frequent job changes by workers have led to calls for more rapid vesting requirements in benefit plans. Many banks have recognized the needs of the younger segment of the work force and attempted to meet these needs through various types of more flexible benefit programs and more rapid vesting of defined contribution plans.

Faster vesting however should not be mandated without weighing carefully the increased costs entailed: not only the costs to fund the benefit but also the administrative and recordkeeping costs in maintaining the funds and records of terminated vested employees until they reach retirement age. ABA has concern over the impact more rapid vesting might have on the continued viability of defined benefit plans.

Portability

ABA has objected to mandatory portability of benefits primarily because we have never seen a scheme which we thought would be workable. It should be recognized that, in practice, the IRA has become in some measure a de facto portability vehicle.

The following benefits to a portability system are recognized:

it would remove from the employer's cost of the administration those amounts attributable to maintaining the funds and records of vested terminated employees.

it would help to protect the purchasing power of an employee's vested benefits.

Recognizing these significant advantages to employees and employers, it may be that portability's time has come. Any proposal for portability of retirement benefits should at a minimum address the following:

the effect on the continued viability of employer plans
valuation of benefits and reasonableness of interest rate assumptions
treatment of cash outs
the potential for a private sector solution
whether participation should be optional on the part of the plan sponsor.

Retirement age

Currently retirement distributions from IRAs may not begin prior to age 59½ without penalty. Consideration should be given to a coherent and consistent policy on early retirement age treatment under private plans, IRAs and tax regulations. Such consistency is lacking today.

Most pension plans recognize age 55 as an early retirement eligibility date.

Favorable tax treatment on capital gains on sale of residence can occur at age 55;

Early retirement (age 55) is becoming more attractive to individuals as they seek second careers (often at reduced salary levels) or receive incentives to retire early to make growth opportunities for younger workers.

Changing demographics, desirability of consistency and other applicable factors should be taken into account as well. In any event the appropriateness of a particular age for retirement should be considered in formulating a retirement income policy.

Increased coverage

If coverage is to be expanded, which seems to be a universally desirable goal, government should at a minimum retain current incentives and explore others to further encourage those employers who for one reason or another have not yet seen fit to establish a plan. At the same time the costs of adopting and maintaining a plan must be kept to a minimum. It should further be recognized that frequent changes requiring continuous plan amendments and increasingly stringent and detailed requirements present cumulative disincentives to establishing and maintaining plans.

Retirement policy oversight

Given the dual jurisdiction over retirement plans in the Congress and the fact that three separate agencies have a role in regulating the private pension system, each with a unique perspective, our Association fears that any policy articulated by Congress will not endure very long unless some ongoing independent body is charged with overseeing and implementing the policy.

For that reason ABA has recommended an independent body whose charter should come from Congress. In addition, section 2 of ERISA should be expanded to include a declaration of policy and purpose to nurture, protect and encourage the growth of the private pension system. The charter of the independent body then would include not only the oversight and protection of the rights of participants and beneficiaries and protection of the private retirement system as well.

Perhaps that body should be a bipartisan Commission. The Chairman would be appointed by the President and include as its members, the Secretary of Labor, or his designee (possibly the Administrator of Pension Welfare Benefit Plans), the Secretary of Treasury, or his designee (the IRS Assistant Commissioner for Employee Plans and Exempt Organizations), the Executive Director of the Pension Benefit Guarantee Corporation and representatives of the public. The presidential appointees, of course would be subject to the advice and consent of the Senate (perhaps Senate Labor and Finance Committees jointly). The Commission should have such staff as deemed necessary and appropriate.

The Commission would meet periodically, review any proposed legislation or regulations which may affect the national retirement income policy and, as appropriate, propose remedial or other legislation deemed necessary to carry out its responsibilities.

ABA is pleased to provide its views to the Subcommittee and looks forward to continued cooperation with the Subcommittee members and staff.

Mr. Clay. Thank you. Mr. Lebed, when you say that you oppose the repeal of the 401(k)'s, isn't it true that when employees change jobs that they have access to the money that they have contributed under the 401(k)'s?

Mr. Lebed. I think that is normally the case, yes.

Mr. Clay. Do you view that 401(k) as a retirement plan or a savings plan?

Mr. Lebed. Well, I would say the 401(k) plans as they are now constituted would have to be viewed as more of a savings plan than a retirement plan, but with strong orientation to savings for retirement. I think that it is very common for people who are terminating, for example, to roll their contributions over into an IRA, and to in fact save money for retirement, rather than pay taxes. If they take their money now, they would pay a tax on it and have lost the tax-favored status of the funds.

Mr. Clay. You say that most of them roll it over into IRA's; you suspect that to be the case?

Mr. Lebed. I would be speculating to say more, but I think that is very common.

Mr. Clay. You have heard some of the testimony, and some of it differed this morning, about the value of IRA's or the danger of them depending on whose testimony you want to believe. Some testified this morning that IRA's discourage the establishment of employer-sponsored retirement plans for their employees. What is your position in regards to that?

Mr. Lebed. As to whether IRA's discourage?

Mr. Clay. Yes.

Mr. Lebed. I think in a very minor degree they do. I don't personally see that as a serious problem. I think that in general IRA's have made a constructive contribution to savings for retirement and represent a good part of the overall system.

Mr. Clay. Mr. Stone, in comparing some of the figures between IRA's and 401(k)'s, I think you mentioned that only 17 percent of those eligible for IRA's were participating. You mention a much higher percentage of low-income people participating in 401(k)'s. Is it because of the way the law is structured that you have a higher percentage?

Mr. Stone. To a great extent. You have the antidiscrimination provisions in 401(k) which require the employer to structure the plan in a manner which will attract the lower two-thirds of the payroll, and that is most often done through an employer match, to an extent, of funds contributed by the employees as well. Something which is not available in an IRA.

Mr. Clay. You have the same position as Mr. Lebed that we should not repeal the 401(k)'s?

Mr. Stone. I think 401(k)'s are one of the best developments that we have had in employer plans for the purpose of providing for retirement income. The plan that my company has does not permit withdrawals and does not provide for loans; it is strictly oriented as a retirement savings program. I am not saying that is the only way and that is the best way; that is the way that we have chosen to implement the 401(k).

Mr. CLAY. You would lock the contributions in?

Mr. STONE. Yes, sir. Other plans provide for withdrawals for college education; purchase of a first house; those are also worthy goals, and they provide a viable means of accomplishing those goals within our system.

Mr. CLAY. Mr. Chandler?

Mr. CHANDLER. Do you feel that Treasury's reform proposals would make it more difficult for individuals to prepare for retirement?

Mr. LEBED. Yes, I do, in a lot of ways. We talked about individual savings here in several different ways, Congressman Chandler. One thing that I did not comment on that I would like to is the role of individual life insurance and annuities, for example, in saving for retirement.

The Treasury proposal would, in effect, tax unrealized increases in reserves or cash values under life insurance and annuities. Very frankly, the life insurance industry is kind of up in arms about that particular proposal, for a couple of reasons.

One, the 1984 Life Insurance Tax Act, which was passed less than a year ago, was the result of about five years of very hard work between our industry, the Congress, and the Treasury as to how to tax life insurance companies and how to tax life insurance products.

The question of how to tax individual life insurance annuities was very, very thoroughly considered at that time and the current arrangements were, and the historical arrangements were very strongly reaffirmed after some amendments.

Now all of a sudden it is back on the table as to how those things are going to be taxed.

Several reasons why those tax-favored provisions were reaffirmed is that life insurance protection of individual families is considered highly desirable, and about two-thirds of the policies that we have in force in this country are for people who are earning less than $25,000 a year. In other words, this is a very widespread form of savings and protection.

The Treasury proposal would impact particularly hard on older people, where the reserves for their life insurance are larger, of course, and I think that would be very counterproductive in terms of individual saving for retirement.

Mr. CHANDLER. Mr. Hayes?

Mr. HAYES. One question. It is not too often that I get the opportunity to talk to people who manage money.

I want to raise a question of Mr. Cowles, if I may.

Mr. COWLES. It is spelled C-o-w-l-e-s; do not worry about it.

Mr. HAYES. You know that our deficit is, I guess, running in the neighborhood of $200 billion, and we are trying desperately to find ways and means to reduce the deficit. This is what really creates problems.

As a matter of fact, it is said that much of our deficit is created just paying the interest on the money that the Government borrows. The thing that sort of disturbs me as we seek ways to do it, one of the things I guess is directed toward a matter of policy as it relates to pensions and other benefit programs.

Some are suggesting we ought to take a serious look at the proposal that we begin to tax pensions and things of that sort. What is your position in respect to that? I do not read it in your statement.

Mr. **Cowles**. Congressman Hayes, taxing employee benefits; there are essentially two ways to do that. One is to tax the employees for benefits they receive; that is, impute income, and I think that might make the President's day.

Mr. **Hayes**. I hope not. Go ahead.

Mr. **Cowles**. And the other is the taxation of the accumulated funds; an income tax or an excise tax on the earnings of accumulated employee benefit funds, and I submit to you, sir, that the purpose of those funds is to provide for the economic security of retired lives which is in many ways what we have been talking about today, and it seems to me that taxation of those accumulated funds reduces the accumulation available to pay benefits and therefore would be contrary, I would hope, to any articulated national retirement income policy, which would be to increase that security.

Mr. **Hayes**. Thank you.

Mr. **Clay**. Mr. Stone, are you generally familiar with Federal employee retirement plans?

Mr. **Stone**. Very generally.

Mr. **Clay**. We have about 37 or 38 different kinds.

Well, are you specifically familiar with the retirement of Members of Congress?

Mr. **Stone**. No; I am not.

Mr. **Clay**. I wanted a little comparison between ours and what IBM provides.

What is the minimum age of retirement?

Mr. **Stone**. It is 55 with 15 years of service for——

Mr. **Clay**. That sounds better already; we have to be 55 with 18 years of service.

Mr. **Stone**. Or at any time with 30 years——

Mr. **Clay**. With contract renewal every 2 years. [Laughter.]

Or what?

Mr. **Stone**. Or, after 30 years of service, and age 50.

Mr. **Clay**. And what would be the percentage of pay that you would receive at that point?

Mr. **Stone**. At early retirement, I honestly do not have the figures; I would guess it is somewhere in the neighborhood of about 30 percent. I will get you the number on it, but it is not a high figure.

Mr. **Clay**. Do the employees make any contributions toward it?

Mr. **Stone**. No, they do not. It is a defined benefit, noncontributory plan which I believe is pretty much the standard for major employers.

Mr. **Clay**. Now, if they put 8 percent of their gross salary on top of what the company provides, can you imagine or can you speculate for us what kind of retirement they would have?

Mr. **Stone**. Well, in fact, that is what we are trying to do with our 401(k) plan as another means, providing additional savings flexibility to the employee group to contribute—as a matter of fact, it is up to 8 percent and the company matches 30 cents on each of the first $5—to savings which provide a tax-deferred growth until retirement, at which time you will have that amount of money available to you, and you will pay taxes on it at that point. The money has grown tax free, but when it comes out, the Federal Government gets its full, fair share.

Mr. CLAY. Well, that is a super fund and a super retirement plan, if that is going to be built on top of your present retirement plan. I am asking these questions because I am on another committee, and we have been given the responsibility of trying to come up with a plan for new Federal employees that were hired since January 1 of last year, and try to do something about our present system. Some people seem to think that we have had such a fabulous retirement plan that we ought to be willing to cut back on the benefits; extend the age of retirement from 55 to 65, some believe.

In particular, one who is raising all kinds of hell about how we are wasting the taxpayers' money is Mr. Peter Grace of W.R. Grace, and I cannot for the life of me imagine why; he has not paid any taxes since 1981, so none of the money belongs to him—and in 1981 he filed a short form.

I just thought I would ask you a few questions. We, certainly, want to thank all of you for your testimony today.

That concludes the hearings until tomorrow morning.

[Whereupon, at 1 p.m., the subcommittee was adjourned.]

OVERSIGHT HEARINGS ON EMPLOYEE BENEFIT PLANS

WEDNESDAY, APRIL 3, 1985

House of Representatives,
Subcommittee on Labor-Management Relations,
Committee on Education and Labor,
Washington, DC.

The subcommittee met, pursuant to call, at 10:05 a.m., in room 2261, Rayburn House Office Building, Hon. William Clay (chairman of the subcommittee) presiding.

Members present: Representatives Clay, Kildee, Biaggi, Hayes, Owens, Roukema, Chandler, Bartlett, Fawell, and Jeffords.

Staff present: Minority legislative associate actuary.

Mr. **Clay**. The committee will come to order.

This morning, we continue our oversight hearings on national retirement policy.

As I indicated yesterday, the subcommittee was flooded with requests to testify at these hearings. Unfortunately, we could only accommodate a small number. The hearing record will remain open until April 24, and I urge you to submit written statements for the record. The extraordinary number of requests we received reinforces the critical importance of the subject before us today.

I want to welcome all of our witnesses and encourage you to be as concise as possible, hopefully keeping your oral remarks to 5 minutes.

Our first witness today is one of our former colleagues, the father of ERISA and for 10 years the godfather for all of those seeking retirement assistance, Mr. John Erlenborn.

Mr. Chandler.

Mr. **Chandler**. Mr. Chairman, Mrs. Roukema, the minority ranking member, asked me to extend her apologies to Mr. Erlenborn and to the members of the committee. She has a conflict this morning with another committee and is not able to be here.

Mr. **Clay**. Mr. Jeffords.

Mr. **Jeffords**. I would like to personally welcome John back before this committee in a different role than he has normally been pursuing.

John, of course, was a Member for 20 years and, as was pointed out, is now retired from Congress and a partner of the law firm of Seyfarth, Shaw, Fairweather & Geraldson, and soon, I'm sure, to include Erlenborn in there at some appropriate time.

He was, as has been pointed out, one of the prime sponsors of the—the original author, really, of ERISA in 1974 and the legislation expanding ERISA in 1978.

It's a pleasure to have you here at an extremely critical time, I think, in the sense that we're not only undergoing a look at pension programs and reform of pension programs and trying to establish a national pension policy, but also at a time when everyone agrees we ought to do something in tax reform.

So it's important to have you before us, so that we can take a look at the implications that what we do here might have on tax reform and vice versa.

Thank you, Mr. Chairman.

Mr. Clay. Mr. Owens.

Mr. Owens. No statement, Mr. Chairman.

Mr. Clay. Mr. Fawell.

Mr. Fawell. Well, only one thing. I am the successor to John Erlenborn in Congress, and I've found that that's a wonderful thing but also has its detriments, because the guy had such an outstanding record, that I think people might be expecting too much of me. So I just wanted to welcome John here.

Mr. Clay. Mr. Erlenborn, I know you are very familiar with the rules of this committee, and the 5-minute rule, as I understand it and interpret it, does not apply to former members of the committee.

Mr. Erlenborn. That's an amendment that I welcome.

STATEMENT OF JOHN N. ERLENBORN, PARTNER, SEYFARTH, SHAW, FAIRWEATHER & GERALDSON, AND FORMER RANKING MEMBER, COMMITTEE ON EDUCATION AND LABOR

Mr. Erlenborn. Thank you, Mr. Chairman.

I do have a prepared statement which I've furnished for the committee. I won't take the time of the committee to read that, but I will summarize.

Mr. Clay. Without objection, the entire statement will be entered in the record.

Mr. Erlenborn. I'd be happy to try to answer your questions. I understand some members have been researching the record to see what tough questions I've asked other people in the past, and they're going to throw them at me today, and I welcome that.

Mr. Chairman, as you know, I had the privilege of serving on this subcommittee and the full Education and Labor Committee for many years. I joined the committee in 1966—the Ed and Labor Committee—filling a vacancy created when Bob Griffin was appointed to the Senate.

Early on, I was appointed to the General Labor Subcommittee, of which our former colleague and good friend, John Dent, was the chairman, and as I know you're aware, Mr. Chairman, that was the subcommittee in which ERISA was drafted and reported to the full committee.

ERISA was many years in the making, and finally, in 1973, a version of ERISA that I had introduced and one that John Dent had introduced were merged in subcommittee, reported out, and that ultimately became the House bill that went to conference.

The conference was very difficult. It included four committees, which was very unusual at that time and still quite unusual. There were conflicts between the labor committees and the tax-writing committees, conflicts which, as a matter of fact, we never did resolve in conference. Instead we passed, in effect, two laws—title I and title II—and sent the jurisdiction in the executive branch to at least three different places—the Labor Department, the Treasury Department, and the newly created PBGC.

Prior to ERISA, the only regulation in Federal law was in the Internal Revenue Code, and the principal thrust of that was, first of all, to encourage the formation of plans which had been quite successful, and then, second, to monitor the tax provisions so that there would not be an excessive loss of revenue to the Treasury.

A few years before ERISA was passed, the focus shifted from encouraging the formation of plans to the security of those who were relying upon pensions that were promised by their employers, and ERISA was a result of that.

Today, we see the focus again shifting, and the focus now is on the revenue loss that is associated with these employee benefits, pension plans being one, but other employee benefits as well.

Mr. Chairman, I think something that you and the other members of the committee as well are quite aware of, is that in the last few years we've had no amendments to ERISA emanating from this subcommittee or this committee.

What changes have been made affecting ERISA have emanated from the tax-writing committees, and the focus of those committees has been almost exclusively on the budgetary and the revenue implications of the legislation with, unfortunately, not enough attention being given to the broad policy considerations as to how this would affect the future of retirees.

I think that it's quite important that future consideration be driven more by policy considerations and not exclusively by these revenue implications.

Let me address the issue directly. As did you, Mr. Chairman, I served on the National Pension Forum, appointed by Secretary Donovan last year.

One of the principal recommendations of that forum was that the Congress adopt a formal national retirement income policy. I endorse that recommendation, and I think that it is key to future consideration of retirement-related legislation.

What form this will take I'm not certain, Mr. Chairman. I presume that your staff has been looking at this and has recommendations. It could take the form of an amendment to ERISA in its preamble and in findings and statement of purpose.

I doubt that that, frankly, would be a good direction to take, since it might be considered to be too narrow and to be only ERISA-related. It would be better, probably, to go the route of a resolution, either a joint resolution or at least a resolution that could go to the tax-writing committees as well as the labor-related committees of both the House and the Senate and then be the statement of national policy.

I don't pretend that this could—and I know that we're all aware that this could not—bind future Congresses. It would probably be only an expression of national policy, but it would be a yardstick against which we could measure proposals for changes in the law—either the creation of new programs or amendments to existing programs, or the repeal of current programs.

I think we need this yardstick. Without that, as I say, the attention from one time to another may be on saving tax revenue for the Government or enhancing the retirement futures of our retirees, but we need a consistent yardstick to be applied to legislation throughout the coming years, and I think the adoption of that policy, though it would have no binding power in law, would be a good step to serve that goal.

What should the policy be? I'm not certain that I can describe that policy to you, but I think it ought to take the form of what we have had in the past and have today, which has for years been described as a three-legged stool, Social Security old-age benefits being the base for most people, and we now have almost universal coverage of Social Security; second, an employer-sponsored plan, and we do have broad coverage.

I think that one of the purposes of the policy should be to encourage even broader coverage of employer-sponsored plans.

What form they should take—defined benefit or defined contribution—probably depends on the circumstances of the individual workforce and the employer. There are advantages to either one.

Then the third leg, of course, is savings—individual savings.

I think that a policy goal ought to be enunciated in terms of a percentage of preretirement income, and the goal should be partially met, but fairly well met, by the first two legs of that stool—Social Security old age benefits, and the employer-sponsored pension plan.

The third leg—private savings—certainly should be much more flexible, and there will be those who will save sufficiently so that they may have income that equals or exceeds their preretirement income from employment.

There are others who will not do such a good job, but I think that that's a matter for individual choice, and I don't think that our policy should in any way restrict or require the accumulation of private wealth to furnish that third leg of the stool.

Mr. Chairman, let me say that there have been those who have suggested that one form of retirement income is better than another.

There are those in my constituency when I was in the Congress who feared that when we created the individual retirement accounts, which, as you mentioned, was one of the things that I proposed was adopted in ERISA, that this was the precursor of doing away with Social Security old-age benefits—we were going to turn to the individual and say, "Here, you may save your money in a tax-free fashion, and we will then abolish old-age benefits and have you rely on your IRA."

I think that would be bad policy. It was never the intention of the Congress when we enacted IRA's. The intention was to furnish the third leg of the stool, not to supplant the first leg.

There are those, the Treasury Department among them, who today would abolish other provisions of law, such as 401(k) in the Revenue Code, and substitute an expanded IRA for 401(k).

I think this also would probably be bad policy. It would move the saving of money in a tax-free environment from an employer-sponsored plan with rules for fairness and equity and participation among all income levels within the company to individual choices made without any way of assuring that we would have broad participation throughout the income groups that would be affected. I think that 401(k), for that reason, does represent a good policy.

I'm not going to go into detail here. This is really a matter for the tax-writing committees, but I would say that there are shortcomings in that 401(k) program as well that make it more of a capital accumulation plan than a retirement savings plan, and if we had a national retirement income policy, we would have that yardstick against which to measure proposals such as 401(k) or proposals for amendment of such programs. I think that that would serve the best interests of our retirees as well as protect the revenues for the Treasury.

Mr. Chairman, in conclusion, let me say that I think this subcommittee should take the lead in the formulation of this policy.

I believe you would agree that we should include, and necessarily must include, the Ways and Means Committee and of course the two sister committees in the Senate as well as the Aging Committee, at least in an advisory capacity.

We should make the adoption of this policy in an atmosphere with as broad participation as possible so that we can have an expression of policy that really is supported by a broad cross-section of people within the Congress and of the country as a whole.

Mr. Chairman, I'd be happy to try to answer whatever questions you might have.

[Prepared statement of John Erlenborn follows:]

PREPARED STATEMENT OF JOHN N. ERLENBORN, PARTNER, SEYFARTH, SHAW, FAIRWEATHER & GERALDSON, WASHINGTON, DC

Mr. Chairman, thank you for this opportunity to testify before this subcommittee on which I had the privilege to serve for a number of years and about a subject in which I have had a great interest for many years also. My testimony today is based upon my service in Congress and, in particular, my service on the Education and Labor Committee and not on my new position as a partner in the law firm of Seyfarth, Shaw, Fairweather & Geraldson.

As most of you are aware, I served in the House from January 1965 until January of this year. In mid-1966, as a result of the appointment of Bob Griffin of Michigan to the Senate, there was a vacancy on the Education and Labor Committee to which I was appointed. One of the subcommittees to which I was assigned was the Labor Standards Subcommittee chaired by John Dent of Pennsylvania. Among other matters of interest to this subcommittee then was "pension law reform" as it was known in those days.

Within a few years, I became the ranking Republican on this subcommittee. Pension law reform was being taken more seriously about this time and hearings were being held to explore the possibility of legislative action.

A few years after gaining the ranking position on the subcommittee, I drafted my version of pension law reform. In 1973, the version sponsored by John Dent and my bill were combined to become the bipartisan bill reported by the subcommittee and later reported to the House.

The Senate, meanwhile, was preparing its version and ultimately the two bills were sent to a joint Senate-House conference committee which, after several months of effort by the four committees involved, finally reported the Employee Retirement Income Security Act which was signed by President Gerald Ford on Labor Day, 1974, and which has since been known by its acronym, ERISA.

Prior to ERISA, the only federal regulation of pension plans in the private sector was through the Internal Revenue Code. The Code's provisions were meant primarily to establish the right of employers to maintain such plans and enjoy certain tax benefits. The principal thrust of tax law in the 1940s and 1950s was to encourage the adoption of pension plans and expand coverage to more employees. In the 1960s attention began to be given to providing greater security to those who relied upon such private pension plans. Thus was born ERISA, with its minimum requirements for participation, vesting, and funding and fiduciary standards. The current attention addressed to the pension industry is based upon budgetary or revenue implications of the tax provisions.

Mr. Chairman, let me stress at this point for the record a fact that I know is familiar to you, namely, that over the past few years the legislation affecting pensions has emanated from the tax-writing committees of Congress and, in the main, has been the result of decisions driven by revenue considerations. Such laws as DEFRA, TEFRA, and ERTA are eloquent evidence of the need for a national retirement income policy as a guide for legislative action. It is regrettable that this committee and the labor committee in the Senate were not given jurisdiction over that legislation so that the interests of workers and retirees could be better protected.

The important point, Mr. Chairman, is that such legislation can be driven by considerations other than the welfare of workers and retirees, and a more formal consideration and adoption of a retirement income policy would give all of us a yardstick against which to measure legislative proposals and help us to make judgments as to their value.

Now, Mr. Chairman, let me address the issue directly.

Over the course of the past few decades, the United States has evolved a system of devices to replace the income which is lost as a result of retirement from the active work-a-day world. The base upon which most people begin their retirement planning is the Social Security old-age and survivors benefit system. The Social Security law, as we know, was enacted in 1935 and modified over the years to adjust the benefits and to index them to inflation. In the 1940s and 1950s several forces combined to cause the widespread adoption of employer-sponsored pension plans. These factors were the tax provisions I mentioned earlier which deferred taxes on contributions to pension plans, wage and price controls during the war years which made benefits more attractive since direct wage increases were not allowed, and the influence of organized labor which bargained for pension and other benefits leading ultimately to the acceptance of such benefits as standard.

In recent years, several tax provisions have encouraged the accumulation of capital for retirement and other purposes. All of these events have led to the existence of a complex of public and private arrangements to provide retirement income. The result has been to create the most financially secure elderly population in the world. The elements that have produced this result are not free from attack, however, and proposals to create new programs and to amend or repeal current provisions are rampant today.

The system or complex I have described has traditionally been likened to a three-legged stool. The legs are Social Security old-age benefits, an employer-sponsored pension plan, and private savings. Since these now exist and have proven successful, why do we need to adopt a policy today?

The Secretary of Labor's National Pension Forum last year featured among its recommendations a call for adoption by the Congress of a national retirement income policy. As a member of that Forum, I endorse that proposal. In my opinion, some of the provisions of law today do not necessarily fit a strategy of the implementation of such policy and others are subject to unwarranted attack. The existence of a formal retirement income policy would provide a guide to evaluate existing programs and proposals to modify them or enact new provisions.

Retirement income goals should be expressed in terms of percentages of pre-retirement income. The percentages should vary, being higher for lower income workers. Such goals would serve to protect the standard of living enjoyed by workers during their active years of employment.

The sources of retirement income should be coordinated to fit these goals and the two principle sources should be Social Security and an employer-sponsored pension plan. The third element, private savings, is and should be much more discretionary and flexible, allowing some to enrich their retirement years with an income exceeding national goals.

We now have almost universal coverage of Social Security. This provides a base upon which a still young but rapidly maturing private pension system has been built. The current tax inducements to maintain private pension plans should be continued and the expansion of coverage should be encouraged.

Some policymakers tend to favor one form of retirement planning over another. For example, it has been suggested that individual retirement accounts (IRAs) be a substitute for Social Security or an employer-sponsored plan. This putting all of one's eggs in a single basket is poor public policy.

I believe that this committee should take the lead in formulating a legislative expression of national policy in regard to retirement income. Recent events on the tax-writing committees lead me to believe that they would be supportive of this effort and would cooperate. The Aging Committee should, of course, be allowed to provide input into this effort.

Equally important is the structuring of the executive branch to help to establish and implement policy. The current diffusion of responsibility among many agencies and departments promotes the use of a narrow viewpoint by each and thwarts the development of an overall policy. A single agency for the enforcement of ERISA and other retirement-related laws would be a positive step long overdue.

Mr. Chairman, I realize that there are many issues that I have not addressed specifically in these prepared remarks. I hope the subcommittee members will have the opportunity to explore these issues with me now in questions and answers and in the coming months as we continue this fascinating inquiry.

Thank you once more for allowing me to participate.

Mr. CLAY. Thank you, Congressman.

At yesterday's hearings, most of the witnesses agreed with you that the IRA's were originally conceived to supplement the Social Security and also the employer-sponsored plans. Some of them, however, suggested that Congress ought to tighten the rules and make sure that IRA savings are used for retirement. What's your position?

Mr. ERLENBORN. The only thing that I know of within the IRA program that may lead to the utilization for purposes other than retirement, is that the excise tax for early withdrawal may not be sufficiently high to discourage taking the funds out for other purposes, whatever they might be—buying an automobile, a house, college education, or some frivolous purpose, for that matter.

So it might be a good policy to increase the excise tax for early withdrawal to encourage the savings of those funds for the retirement years.

There is a similar problem with 401(k)—and I didn't go into detail there—but it permits liberal loan policies and liberal withdrawal for hardship without any definition yet within the law or regulations as to what hardship is.

There is 10-year forward averaging, which encourages taking out a lump sum at retirement age, and that does not necessarily mean that that lump sum will then be utilized to protect income for the future of the retiree.

These are things, I think, that would be measured against a national retirement income policy, if we had one, and might come up short and wanting, and might then suggest amendments to the current law.

Mr. CLAY. When you speak of a national policy, is it really realistic for us to expect or to set a national goal of 100 percent coverage?

Mr. ERLENBORN. It may be very difficult to have 100 percent coverage. I think that you can come pretty close to 100 percent coverage under old-age benefits—Social Security old-age benefits.

Employer-sponsored plans would be much more difficult to have that broad a coverage, since there is a great deal of mobility in some parts of the workforce, and it would be, in my opinion, quite difficult to have employer-sponsored plans for all.

There have been proposals for mandatory universal pensions—the MUPS, for instance—but I think even those proposals usually had some exemptions, so that not all employers would have to furnish these plans.

But I think that in the case where there is no employer plan, those who are able could then use the third leg of the stool—private savings—as a greater supplement for their retirement years.

Mr. CLAY. Do you support or recommend a mandatory minimum universal plan?

Mr. ERLENBORN. No, I certainly would not. Let me tell you why, Mr. Chairman.

I greatly fear any kind of legislation that would set benefit levels for private pensions—employer-sponsored plans.

The scenario that I see as being almost inevitable is that, in the future, after that were done, future Congresses would look at the retirement picture and say, "We ought to have greater retirement income for retirees. It's a good thing politically to furnish that. Now, we have a choice of either raising old-age benefits and raising the taxes to pay for that, or mandating that the employer increase his share."

I find it rather difficult to believe that any future Congress would ever increase old-age and survivors' benefits, because then we'd have to raise the taxes to pay for it. It would be almost inevitable that the Congress would then turn to the private sector and say, "You must raise your benefits," and let the employer worry about how that's going to be paid. I don't think that would be a good situation.

Mr. CLAY. Thank you.

Mr. Chandler.

Mr. CHANDLER. If I could follow along with that line of questioning, Mr. Erlenborn, yesterday we had testimony from Lyle Carter, whom I'm sure you know. He represented the President's Commission on Pension Policy, which has advocated some form of a mandatory approach.

He mentioned as one of the three options a second tier to Social Security which would be a privately-invested mandatory employer program. Are you familiar with what he means by that and how it would work. What do you think of it?

Mr. ERLENBORN. No, I'm not familiar with that.

Mr. CHANDLER. I assume what he's talking about is, if you're an employer and you don't have a private plan, then you'd have to pay some enhanced level of contribution of Social Security, and that then would become the employee's private retirement.

Do you have an opinion of an approach like that?

Mr. ERLENBORN. Well, it sounds to me like a super Social Security—a Social Security on top of Social Security—and it does not appeal to me offhand. I can see some hazards in going that route.

Mr. CHANDLER. You have answered some of my questions—questions that I had written myself—like where in the the law we should put a national retirement income policy, what form it should take, you answered that—a kind of a guideline, and in part what it should address—a percentage of preretirement income—how far do you think we ought to go in that? Should we address the issue of retirement age? Should we address benefits other than retirement income? Should it address health benefits, for example, and that kind of thing? How far into that list of policies should we go with a national retirement income policy?

Mr. **Erlenborn**. Well, I've given some thought to this, and I've addressed my remarks here today only to the actual replacement of preretirement income and in the form of benefits or savings, but I think that you suggest something that is very likely an element that should be included, and that would be something such as health insurance.

Postretirement health insurance is an issue, by the way, that I think is going to be addressed. It's now being considered in the courts, and there are some recent decisions, and I think it is likely then to be addressed by the Congress, so that we can eliminate what confusion the different court decisions may have created.

But we're talking about a massive amount of money. I've been doing a lot of speaking around the country, talking to employers and benefit managers, and I've been asking them how many have postretirement health insurance. A large number do. Most of them think that it's on a voluntary basis and could be withdrawn by the employer at any time.

The *White Farm* case in Ohio, which is at a very low level of the judicial process—I think there's an appeal from the bankruptcy court to the district court and hasn't gotten to the court of appeals yet—but in that case the court held that, as a matter of common law, the employee who retires becomes vested in those health insurance benefits, and they cannot be taken away or changed.

I've also asked employers and benefits managers if they have cost out the furnishing postretirement health insurance, and most of them have not. The few who have have blanched at the results.

Massive amounts of money would be involved in this postretirement health insurance. I think it's something that employers should be spending more time giving attention to, particularly in the state of flux that the law is in, but it is also an important element of retirement policy.

If one has such health insurance as a supplement to Medicare, then your need for cash flow during retirement is reduced. If one doesn't have it, you must have a greater cash flow. So I think it is really a very important part of the whole picture.

I might also say, there is a tendency, which might be accelerated in the future, to shift the cost of post-65 health care to the private sector. We've already done that between 65 and 70, so that the primary source becomes the private health insurance instead of Medicare. I can see this accelerating as well, as we want to take the pressure off raising funds to support Medicare.

It's a complex subject, but I think that this is part of the national policy and should be.

Mr. **Clay**. The time of the gentleman has expired.

Mr. Owens.

Mr. **Owens**. Mr. Erlenborn, welcome back.

Mr. **Erlenborn**. Thank you.

With your extensive knowledge of this subject, I want to take a slightly different tack and ask if you might comment for a moment on some comparative ways that our foreign competitors handle the problem of pensions and retirement.

Do Germany and Japan, for instance, give a greater sense of retirement security to their workers for a cheaper cost?

Inevitably, that's going to become a part of that equation whereby we figure in how competitive we can be. The cost of labor—total—includes retirement and fringe benefits. I'd just like to know if you are aware of any significant differences or better ways that these other competitors do it.

Mr. Erlenborn. I'm not aware. I've not made any extensive study of retirement systems in other nations, but I would be surprised if you could find very many, if any, countries that had a more secure elderly population than we have in the United States.

I think our combination of Social Security and employer-sponsored plans has provided income on the average for our retirees that equals or exceeds that in most of the industrialized world. Certainly I don't think it could be done for less cost.

Now, some of the costs are difficult to measure. For instance, we require under ERISA prefunding or amortization of the cost of these pensions. That means the employer must put away today the normal cost and also provide amortization for the unfunded past service benefits that have been earned.

One odd feature of this is that that increases the amount that then becomes a tax deduction and increases the concern of the taxwriting committees.

You see, what we might do to satisfy Ways and Means and Senate Finance about the tax law is to say, well, we could repeal the funding provisions or liberalize—make less strict—the funding provisions of ERISA, and then there would be less tax loss, but I don't think that that would be a very wise thing to do.

Most other countries, I think—the ones that you mentioned—rely on public plans, unfunded. They're really not cheaper; you're just passing the cost on to future generations. We're funding ours and providing at the same time investment capital that is very important to this society.

Mr. Owens. Doesn't that greater reliance on public plans end up being a subsidy for industry, which puts them in a more competitive position with our industries? The private employer pays less as a result of the Government paying more, and the private employer is in a better position to price his products below our products.

Mr. Erlenborn. Yes, certainly in terms of current costs to the employer. A lot of the cost is, as I say, passed on to future generations.

But I would say that we should take a warning from what's happened with our Social Security System. It appeared to be a very cheap system and one that gave great benefits for small amounts of taxation. That has been true but will not be true in the future, with the funding problems we've experienced with Social Security.

Even though it's not a funded—in the actuarial sense—program, we have found now that we have had to greatly increase the tax burden on our current employees, and it is unlikely that the ones who are working today, when they retire, will get back what they have been required to pay in during their working life.

I would also say that some of the experience I've heard in Western Europe has led me to believe that their programs are in trouble as well.

I recall some of the Scandinavian countries were trying to cut back on their benefits, because they find they cannot support them.

Mr. **Clay**. The time of the gentleman has expired.

Mr. Jeffords.

Mr. **Jeffords**. Thank you.

I'd like to go along on this line of questioning.

First of all, I'd like to ask you relative to tax reform—we're hopefully involved in that, and we all want to be—it would seem to me that what happens in that tax reform may either seriously help or hinder what we're trying to do in pension reform, unless we act now.

If we don't reserve our share of tax expenditures or priorities under tax reform, we're going to be in a very difficult position of trying to make inroads after important decisions are made in that area.

I would guess then that one of our goals ought to be to ensure that retirement is considered as a priority for tax expenditures. That's an easy statement to make, and I think we all would agree with that—that it's absolutely necessary that in any tax reform we have to have expenditures in this area.

The more important question, I think, is, what should we do to try and provide guidelines to the tax-writing committees as to how much of tax expenditures they ought to set aside that will be necessary to implement what we would like to see in the retirement area?

I would like to ask you if you agree with that, and, if so, how do we do that?

Mr. **Erlenborn**. Well, I think that it's not a simple task. I think that if the approach were to say, "We want you to set aside *x* number of billions of dollars for fiscal year 1986 for these programs," we'd find it pretty hard to sell to the tax-writing committees.

One of the problems that we have is that we've now formalized what we call tax expenditures, and the administration is required each year, in submitting the budget, to also give an estimate of tax expenditures under current law.

Those tax expenditure estimates made by the Treasury Department are a snapshot taken at the current time of what they expect to happen during the next year without any consideration for what is already in the law to change the circumstances in the future or of demographic changes.

Now, what I mean by that is, in the pension field—private pension field—for instance, they will look at fiscal year 1986. They will say there will be *x* number of dollars paid into pension plans that will not be taxed, and there will be a tax loss to the Treasury of *x* number of billions of dollars.

They will then say *x* number of retirees will be drawing benefits in that year, and they will be paying taxes at an average rate of, and therefore we will be recapturing *x* number of dollars, and they'll deduct that, and they'll come out with a tax loss figure.

They're looking at a system that is not yet mature. It is maturing. But as it matures, you're going to change the ratio of current workers to retired former workers, and you're going to have a larger proportion of retirees with higher average incomes paying more taxes. As that happens over the course of the years, that tax picture is going to change, but that snapshot picture that we get in the estimate of tax expenditures from Treasury doesn't take any of that into account.

The fact is that we will recapture—and remember, this is not tax forgiveness; this is tax deferral for most of these pension plans—we will recapture, it's estimated, 70 to 80 percent of the taxes that are lost. Now, that's not today, but that will be in the future.

There is a cost; we're not going to recapture it all; but I think what we have to tell these tax-writing committees is the cost is well worth it for the kind of secure retirement income that our workers are being guaranteed now with employer-sponsored plans.

The same thing, in a little different way, can be said about health insurance. There it is tax forgiveness. You don't recapture that, because the employee pays tax neither on the premium nor on the benefits.

But I submit that if we hadn't had these tax provisions that encouraged broad coverage—and we have 80 percent of the private work force covered by employer-sponsored health plans—if we didn't have that broad coverage, we would have had national health insurance by this time, with all of the inefficiencies and waste that's attendant with Medicare and Medicaid, at a greater cost to the Treasury and greater cost to society than the private system that we have.

These, I think, are the things that we have to say to the tax-writing committees, instead of saying we'd like you to set aside *x* number of dollars in this year's budget for these tax expenditures. I think we have to show they're not as great as they're being estimated in the long run, and, second, the cost is worth the result.

Mr. **Jeffords**. Thank you.

Mr. **Clay**. Mr. Hayes?

Mr. **Hayes**. I have no questions, thank you.

Mr. **Clay**. Mr. Fawell?

Mr. **Fawell**. Just one question.

John, you had indicated that, as far as withdrawal from IRA's is concerned, they should possibly be more restricted.

What about the ability of employees under employer-sponsored plans when they leave service or for whatever reason—I've seen so often—in fact, some, I think, because they do have a nest-egg and its vested, it will almost invite them to separate from service so they can obtain those funds and spend them.

Would you comment on that area?

Mr. **Erlenborn**. Yes; as a matter of fact, we sometimes work at cross purposes unwittingly, but some of the provisions that we have enacted in recent years relative to ERISA encourage the creation of small benefits for short-time workers which then they will get out in the way of cash when they are separated, and they will use it as current income, so that in many ways retirement plans have now sort of unwittingly been turned into severance pay plans as well as retirement plans.

In another way, we've also made them life insurance. I think that buying life insurance would have been cheaper, would have been cleaner and better, but in some ways we've made our pension plans into life insurance as well.

There's a tendency to look at ERISA or any other program and think of it as taking care of all the problems as though there were no other elements involved. I think that those blinders that we sometimes have on encourage us to make out of ERISA something that it ought not be and get away from the focus of a retirement income.

So I thoroughly agree with you that we ought not have ERISA being made into, as it has been, a severance pay plan or life insurance plan. Those things can better be taken care of separately in other plans.

Mr. **Fawell**. Thank you.

Mr. **Clay**. Mr. Biaggi?

Mr. **Biaggi**. I wasn't here to hear our former colleague, Mr. Erlenborn's comments, but I'd like to welcome him and acknowledge for the record—and I'm sure that's not necessary—his expertise in this area and congratulate the law firm which was fortunate in obtaining his services.

Mr. **Erlenborn**. I wish my partners were here. I'll get a copy of the record. [Laughter.]

Mr. **Biaggi**. It's on the record, John.

But I am still in the process of reading your statement. I'm not in a position to make comment, but clearly the comments you've made so far about, absent our Government's activity and private activity in health care, we might have a national health insurance plan in effect.

Of course, our concern has been for some time that we do have a national health insurance plan, and that's another area with relation to a retirement policy. You address it here, but I haven't completed reading your comments, but I will.

Mr. **Erlenborn**. You will note that I did mention including the Aging Committee in the consideration.

Mr. **Biaggi**. Clearly, you were referring to our presence.

Mr. **Erlenborn**. I was deferring to you. Aren't you still on the Aging Committee?

Mr. **Biaggi**. No, sir. But the comments I've read, I thank you for but, more importantly, your presence and your contribution, which I know have always been meaningful.

That's all, Mr. Chairman.

Mr. **Clay**. Well, John, we certainly want to thank you for your appearance here this morning.

Mr. **Erlenborn**. Thank you.

Mr. **Clay**. The next witnesses consist of a panel—Mr. Robert J. Myers and Dr. Emily Andrews.

Without objection, your entire statements will be entered into the record, and you may proceed as you see fit, considering our time constraints.

STATEMENTS OF ROBERT J. MYERS, FORMER CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION, AND EMILY ANDREWS, RESEARCH DIRECTOR, EMPLOYEE BENEFIT RESEARCH INSTITUTE

Mr. MYERS. I am very glad to be able to participate in this hearing about a national retirement policy, because I have been interested in retirement matters for many years.

There are several different philosophies of Social Security or economic security. There are some people who believe that the entire economic security should come from governmentally-established and administered plans. There are people, on the other hand, who would go so far as to phase out Social Security and have the entire responsibility be in the private sector.

My own view is that, as with so many things in our pluralistic society, this should be a mixture. The Government should provide a basic floor of economic protection, and people should build on that, along with their employers, in the private sector to establish sufficient economic security as they may desire.

This is about what we have done in this country. I think that it is working out quite well.

But in order to do this, the governmental plan—that is, Social Security—must be established on a basis that gives relatively larger benefits to low-income persons than to high-income persons. The reason, as this committee is well aware is that it is very difficult for private pension plans or IRA's to be developed that will include people at the very lowest income levels.

Therefore, our Social Security system has paid much larger benefits to those at the low part of the income scale. Such persons can do things for themselves to some extent—home ownership and so forth. People at the higher income levels have private individual savings, pension plans, and so forth.

In addition, we have had for many years, as the phrase now is, a safety net of Supplemental Security Income that provides public assistance to people whose incomes otherwise are not sufficient for minimum maintenance. I think that we are at a very desirable situation such that only 5 percent of Social Security beneficiaries do not have sufficient income both from Social Security and their own resources, so that they must get Supplemental Security Income payments.

Briefly speaking, the present situation of the Social Security system, as came out recently in the trustees report, after I had prepared my testimony, is quite satisfactory. It appears that the reform that was enacted in 1983 is operating successfully.

It should be noted that this reform based the financing of the system on the assumption there would be very pessimistic economic conditions. However, actual economic conditions have been better. The system is now in much better shape than was estimated then. But I would not say that it is "out of the woods" yet.

There is only a very small possibility that there will be any financing crisis in the next 15 or 20 years at the very least. I think that, over the long run, the system probably is adequately financed, but of course no one can predict with accuracy 25, 50, or 75 years ahead.

As to a national retirement income policy, I think this should be developed, but I do not think that it should be legislated. I think that it should be developed by sessions such as this that will educate the public and press about retirement income goals.

Legislation may flow from meetings like this, but I do not believe that there should be some overall law passed saying that "this is our national retirement income policy".

Among the important matters that need to be considered in connection with private pension plans is what I believe to be the desirability of indexing the pensions so that, if possible, they maintain their purchasing power. This absence of indexing is one of the great weaknesses of private pensions now—a weakness that is not present in the Social Security system.

I realize as an actuary that indexing is a very costly matter. I do not think that it should be legislated that private pensions must be indexed. There are various ways of meeting the cost of indexing private pensions.

One way of doing it without any cost at all is to provide an automatically increasing pension at the rate of, say, 3 or 4 percent a year, which may come close to keeping up with inflation. The pension amount would start out lower than at present and end up higher. Rather than having a pension now that is level in dollars, but that deteriorates over the years as the cost of living goes up, even if it only goes up slowly, there would be a slowly rising pension—in dollars.

Another way is to build indexing into the pension plan itself. Of course, this involves higher cost for both the employer and the employee, but, again, it might be desirable to do this and then cast the plan on a little lower level, so that the pension starts lower, but it does tend to maintain its purchasing power.

Again, I would not legislate that plans must do this, but I would at least see that the governmental regulations do not prevent it. There are some IRS regulations that prevent private pension plans from indexing.

The other important matter that affects private pension plans is what should be the normal retirement age—in other words, the age at which full benefits are first payable. Under ERISA, this is now prescribed at age 65.

I would very much urge that this be increased just as the Social Security minimum retirement age—normal retirement age—has been increased. It is done on a long-deferred basis. It must be done that way. People should not be faced with the fact that next year the age would be much higher, but rather they are given advance notice, and then it is done gradually.

I think that it would be very unfortunate if this is not done, and if people under private pension plans could retire earlier than the workers who are not under private pension plans, who are probably more economically worse off.

I think that this is something that needs to be done. I will not here go into the reasons why the normal retirement age should be higher. There are many compelling reasons to do so, and the Congress saw that in 1983 insofar as Social Security is concerned.

As to the integration of private pensions and Social Security, which I think is a desirable thing in general, so that the total retirement package is reasonable, I have always seen one great weakness.

In offset plans, where the plan can subtract a portion of the Social Security benefit, it is permitted to do that on the basis of the total Social Security benefit, including any part thereof based on wages from other employers. This, to me, just does not seem logical. The plan should only be able to offset the part of the Social Security benefit that arises from that particular type of employment.

When we come finally to health benefits, which, as Mr. Erlenborn in the discussion here said, is a very important element in retirement income, the situation on the Social Security side of Medicare is now a little brighter than it was before.

In early 1983, it was thought that the Hospital Insurance Trust Fund would go bankrupt in 1989. Now the good news is that the intermediate estimate says 1998. But still, that is not good news to say that it is going to go bankrupt. However, it gives a lot more time for something to be done about the problem and for the experience to develop.

If anything is to be done about the problem, there are various courses to take. It must be realized that this is not a problem of Medicare alone. It is a problem for the entire working population too, because the costs of all health insurance have gone up so much.

The first remedy is greater efficiency of operation. This is something always to be desired, and any organization can improve. There are efficiencies that are possible in health care delivery, such as greater use of ambulatory surgical centers, second opinions, and pre-admission testing. However, there is a limit to how much this can do.

As our scientific developments produce better and better health care, it is going to cost more.

Now, this being the case, there are two things that can be done. Benefits can be reduced so as to make people pay more under the cost-sharing provisions, or the quality of medical care can be lowered.

I do not think that people want this, but that is what has been done in some countries, like in England, where they prohibit operations of certain types for people over age 60. It can happen in this country through poorer nursing care in hospitals because hospitals cut down on the number of nurses.

Mr. CLAY. The gentleman has 30 more seconds.

Mr. MYERS. So, the only other solution is perhaps to raise taxes. That is never a popular thing, but I think that the American people want better health care. As science improves, people would be willing to pay for better medical care through higher payroll taxes for Medicare, and they would use part of the gains in productivity over the future to provide health care instead of other good things in life.

Thank you. Mr. Chairman.

[Prepared statement of Robert J. Myers follows:]

Prepared Statement of Robert J. Myers, Former Chief Actuary, Social Security Administration

Mr. Chairman and Members of the Subcommittee: My name is Robert J. Myers. I served in various actuarial capacities with the Social Security Administration and its predecessor agencies from 1934 to 1970, being Chief Actuary the last 23 years. In 1981–82, I was Deputy Commissioner of Social Security. Then in 1982–83, I was Executive Director of the National Commission on Social Security Reform. In 1979–81, I was a member of the National Commission on Social Security, having been appointed by the House of Representatives. I am a Fellow and a Past President of the Society of Actuaries and a Member and Past President of the American Academy of Actuaries.

PHILOSOPHIES WITH REGARD TO SOCIAL SECURITY

Before getting into the subject under consideration, it may be well to set forth my philosophy as to the Social Security program, by which term I mean the Old-Age, Survivors, and Disability Insurance system (OASDI). In this way, I trust that any bias which creeps in on this account will be recognized as such.

At one extreme is the expansionist philosophy. This holds that OASDI should be broadened to such an extent that its benefits would provide complete economic security for virtually all of the covered population.

At the other extreme is the contractionist philosophy. This holds that OASDI should be phased down—and should ultimately be eliminated.

Between these two extreme philosophies is the moderate one. Under this, the necessity that OASDI should provide a basic floor of economic protection is recognized. In addition, there should be ample opportunity (and even necessity) for those in the middle and upper income levels to provide themselves with additional protection through the private sector. I hold to this philosophy, which is well in accord with what the OASDI program has been in the past and is likely to be in the future.

Consistent with the moderate philosophy, I believe that OASDI should be financed solely through direct, visible payroll taxes. Thus, no subsidies, direct or indirect, from the General Fund of the Treasury should be injected. To do so hides or obscures the true cost situation.

REASONABLE RETIREMENT-INCOME GOALS

Obviously, most individuals would say that their retirement-income goal is to have as much net after-tax income as when they were working—or, perhaps, even more, because most mortals are never satisfied with their incomes! To be realistic, and after considering the generally lower taxes after retirement (including the absence of OASDI taxes) and the elimination of work expenses, post-retirement income goals should be about 80–85% of previous gross pay for low-income workers, about 70–75% for average-income workers, and about 60–65% for high-income workers. My figures are based on various studies that I have seen over the years, none of which can be completely precise.

HOW SHOULD RETIREMENT-INCOME GOALS BE MET?

The expansionists would say that these goals should be met, for virtually all individuals, almost entirely from OASDI. The contractionists, on the other hand, would advocate that these goals should be met primarily through private-sector actions. However, my view is that, in our democratic pluralistic society, the solution should be a multiple one, involving OASDI as the basic floor, and then building on it private pensions and individual savings efforts. In addition, for those whose retirement income from these sources falls short of providing minimum subsistence, there should (where possible) be help from their children and, as a last resort, from governmental public assistance, such as Supplemental Security Income.

OASDI benefits should be at such a level for low-income persons as to virtually provide the retirement-income goal in most instances. this is actually achieved by the weighted benefit formula under OASDI. Persons who had had incomes somewhat below the average can usually meet the goal through OASDI benefits, plus pensions in some cases and home ownership in most cases as well as some personal savings. Those with average incomes and somewhat-above-average incomes should be able to meet the goal through the same means, but with a much greater likelihood of having substantial pensions and savings. Finally, those at the highest income levels should have substantial supplementation to OASDI benefits through private pensions and personal savings.

Specifically, upon retirement at age 65, steady workers who have average earnings throughout their working lifetimes will currently have benefits, exclusive of auxiliary benefits for spouses and children, which are about 42% of their final pay. The corresponding replacement rates for workers with low earnings (about half of the average, or close to the legal minimum wage) is 64%, while that for maximum-creditable-earnings is 23%.

Over the long run, these replacement rates for new retirees at the Normal Retirement Age (currently 65, and ultimately—in 2027 and after—67) will remain almost unchanged. This trend is certain to occur—as can be proved mathematically—because of the consistent, logical indexing procedure adopted in the 1977 Amendments. The ultimate replacement rates will be about 41% for average earnings, 55% for low earnings, and 27% for maximum earnings.

AS a result of this stability, private plans can be structured to build on top of OASDI benefits so as to produce a reasonable level of total retirement income.

FINAL SITUATION OF OASDI

Up to this point, I have advocated that any national retirement policy should have as its foundation with respect to income needs the OASDI program. However, there are many public critics of this program who strongly assert that this program is doomed to failure and bankruptcy before too many years. And, unfortunately, many people—especially younger ones—are convinced that this is what will occur.

The Social Security Amendments of 1983 were intended to solve the financing problems of OASDI, both over the short range and over the long run. The short-range estimates (for the 1980s) which were used as the basis for developing the financing of the system were based on several different sets of assumptions as to future economic conditions. However, the actual financing provided was developed on the basis of pessimistic ones. Up to now, economic conditions have been somewhat better than the intermediate estimate, let alone the pessimistic one. As a result, the balance of the combined OASI and DI Trust Funds as of September 30, 1984, was $6½ billion higher than according to the original pessimistic-cost estimate, and $2 billion higher than the intermediate-cost estimate.

The probability is thus very high that OASDI will have no financing problems in 1985–87. If this is so, then no problems should arise for at least several decades thereafter. This is so because the OASDI tax rate increases substantially in 1988, and again in 1990, and the demographic situation will be favorable for some years to come, as a result of the number of persons reaching retirement age each year ceasing the steady rise that had occurred in the past (due to the annual number of births in 1925–39 being lower than in preceding and succeeding years).

Obviously, precise cost estimates cannot be made for many decades into the future. However, the intermediate-cost estimate for the next 75 years seems to be reasonably reliable. According to it, OASDI will be in close actuarial balance over this period.

A NATIONAL RETIREMENT-INCOME POLICY

The question has been raised as to whether there should be a national retirement-income policy and, if there should be one, how should it be implemented and administered. I believe that discussion sessions such as this hearing are very helpful in educating the citizenry about this important matter and in getting people to think about it. However, once the basic floor of OASDI is established and is being adequately and soundly maintained, and once that broad, general rules for regulating private pensions have been put into effect (as this committee has done through ERISA), I believe that governmental action through legislation and subsequent administration is unnecessary, even undesirable.

Let me next deal with several general matters which should be given consideration in connection with retirement-income national policy.

INDEXING OF BENEFITS AND PENSIONS

I am a strong believer in the general principle that both OASDI benefits and private pensions should be indexed so that they maintain the purchasing power which they had when they were initially granted. This seems basically equitable, as long as it can be financially feasible and supportable. It may be that, in some instances, this seems too costly to do, especially if the initial level of pension benefit is too high or is made available at too young a "retirement" age. The blame for the high cost then is on the other factors, not on indexing per se.

OASDI benefits have been indexed by the changes in the CPI ever since 1975 and will continue to be, except possibly when the trust-fund balance is unduly low. The

CPI may not be a perfect tool for indexing, but it is a reasonable one, and certainly the best now available.

I do not believe that the indexing of OASDI benefits should be done under any and all circumstances. If there is a financing problem in doing this, then I would agree that indexing should be lessened, or even temporarily suspended. The provision for such reduction could well be more stringent than that in present law.

However, I do not agree with those who currently suggest lowering or reducing the COLA for December 1985 solely for the purpose of reducing the horrendous general-budget deficit. The OASDI program is not responsible for this deficit, and it should be required to aid in its solution. And, furthermore, the trust funds have sufficient resources to finance this COLA.

Private pensions are only rarely indexed after retirement and even then only on an ad hoc basis, rather than automatically and only to the extent of partially maintaining the purchasing power of the initial pensions amount. To my mind, this is the greatest weakness of private pensions. To a considerable extent, there is indexing prior to retirement to reflect changes in economic conditions—namely, by basing the initial pension amount on "final" average salary (often over the last 3 or 5 years). Actually, I would prefer that such indexing be done on the basis of a career average of indexed earnings (as OASDI does), because this is more equitable to those with only slowly rising "real" wages over their working careers as against those with sharply rising ones, especially at the end of their careers.

As an actuary, I well recognize the cost problems—and even cost uncertainties—of indexing pensions to the CPI. But there are two ways that a good approximation to this can reasonably and safely be done.

First, the actuarial cost estimates could be based on an interest rate of only 2-3% (the "real" interest rate over the long run, net of price inflation), not on what is considered a conservatively low rate of 6-8% as compared with actual earnings. Then, any interest earnings on the reserves for pensions in force in excess of those based on the valuation rate should be used to provide additional pension amounts—which may well provide COLAs approximating what CPI indexing would do.

If a consistent assumption as to the rate of salary increases is used, this will have no significant effect on the cost of the initial-pension level. However, quite obviously, it will have a significant increasing effect on the cost of the ongoing pensions after retirement. Such cost could well be met by having a lower initial pension level (after all, is it not better to have a smaller initial pension which subsequently maintains its purchasing power than a higher initial one that "withers on the vine"?). Or else there could be higher normal retirement ages, as well as early-retirement reduction factors which are not "actuarial bargains".

Second, the initial pension amount—which is customarily a level amount for life—could be acutarially converted to an annually-increasing amount, such as by 3% or 4% per year. This would result in a lower initial amount, but in a benefit design that would come much closer to maintaining the purchasing power of the initial pension. For example, for retirement at age 65, instead of a level pension of $500 per month, under the 3%-increase basis the initial pension would be about $381 and would increase to $512 at the end of 10 years and $688 at the end of 20 years. The corresponding figures for the 4%-increase basis would be $338 initially, $500 after 10 years and $741 after 20 years. Such an increase basis could be either at the option of each retiree or, preferably, mandatory for all retirees. In any event, this procedure would not increase the cost of the pension plan.

It would also be possible to work out a combination of the two methods, so that larger initial pensions would be provided, with the cost increase being met in other ways.

Although I strongly believe that indexing of pensions in force under private pension plans is desirable, I would oppose this being made a legal requirement under ERISA. It should be encouraged. Certainly, it should not be discouraged by governmental regulations, as the IRS does under Section 415 of the Internal Revenue Code.

NORMAL RETIREMENT AGE

The Social Security Amendments of 1983 increased the Normal Retirement Age (NRA), the earliest age at which unreduced benefits are available, from age 65, which had always applied in the past, to age 67. This is phased in gradually, beginning in 2003 and getting to age 67 in 2027. In my opinion, this was a most desirable change. It recognized increasing longevity and the accompanying improvement in health and work ability—not necessarily equal proportionately—that occurred in the past and is extremely likely to occur in the future.

Those who oppose this change have two basic arguments against it. First, they state that it represents a benefit reduction. While this is true in absolute terms, it is not so relatively, because it merely keeps the system up to date with demographic changes. This is exactly the same as benefit increases which are made to reflect changes in economic conditions—these are not "real" increases or liberalizations. Second, they argue that, because people live longer, they may not necessarily be able to work longer, or jobs may not be available to them. If this does actually occur—which I doubt then the increases in the NRA can be eliminated somewhat before they would become effective. But it is only fair and humane to schedule such increases for some long-distant future date, so that people can adequately make their retirement plans well in advance. It is easy to eliminate any increases in the NRA before they occur, but difficult to put them in when needed if adequate advance notice is not given.

ERISA requires that the NRA under private pension plans may not exceed 65. This should be changed as soon as possible so as to mesh with the NRA changes in OASDI. It would not be at all equitable if beneficiaries of private pension plans continued to receive full retirement income at age 65, while those less fortunately situated, without private pensions, had to wait two years longer to receive unreduced pensions.

Employers who wish to have earlier retirement ages than OASDI provides, in order to "get rid of older workers", and who thus might oppose having a higher NRA in their own pension plans, should instead adopt better and more effective personnel practices. They should, by adequate training and supervision, make more effective use of healthy older workers. After all, the more persons who are employed, the larger will be the national product and the higher the standard of living of the entire populace.

INTEGRATION OF OASDI AND PRIVATE PENSIONS

Some types of private pension plans integrate OASDI directly by offsetting a portion of the OASDI benefit. In general, this is a quite appropriate procedure in arriving at adequate aggregate retirement-income protection.

One permitted procedure, however, is in my opinion unwarranted—namely, using the OASDI benefit based on all of the employment of the individual involved, rather than only that with the particular employer which is providing the private pension. To use employment with other employers in computing the OASDI benefit from which the offset is determined seems to be giving an inequitable "free ride" to the private pension plan. Moreover, this procedure results in the anomalous situation that two employees with exactly the same earnings record with the particular employer and the same demographic characteristics will receive different private pension amounts if their employment history with other employers is different.

IMPORTANCE OF HEALTH BENEFITS

Up to this point, I have discussed only the cash portion of retirement-income needs. Because of the uncertain nature of health-care costs, which can become of catastrophic size, the provision of health benefits for retirees is essential.

For retirees aged 65 and over, Medicare benefits provide a very substantial floor of economic protection. The vast majority of retirees have additional protection through employer-sponsored health benefits or individual Medigap policies. Very-low-income persons (and some others) have the protection afforded by the means-tested Medicaid program. However, there are many who fear that Medicare has catastrophic financial problems in the near future and that therefore its benefits will be curtailed.

Even though OASDI is in reasonably good financial condition, this is not true for the Hospital Insurance portion of Medicare. All estimates for HI indicate that, at some future time, income from payroll taxes will be insufficient to finance outgo, and that the balance accumulated in its trust fund will be exhausted.

The Supplementary Medical Insurance portion of Medicare has no direct financing problems, because the enrollee premium rates and the accompanying matching amounts from the General Fund of the Treasury are established on a year-by-year basis, and so can be increased as the future costs arise. Of course, one can well argue that these costs (to the enrollees and the Federal Government) will increase to too burdensome levels, but this is a financial matter, not a financing one.

Estimates differ considerably as to when the HI Trust Fund will be exhausted under the present benefit and tax-rate provisions. Under the 1984 Trustee Report, this point of crisis will be during 1991 under the intermediate estimate, 1989 under the pessimistic estimate, and 1995 under the optimistic estimate. The 1985 Trustee Report presents a somewhat brighter picture.

In February, an estimate based on the economic assumptions underlying the President's Budget for FY 1986 was released. This showed that the HI Trust Fund will increase by $9 billion in 1990, whereas the intermediate estimate in the 1984 Trustees Report showed a $10½ billion decrease. I project that, thereunder, the HI Trust Fund will increase throughout the 1990s, and not until 2005-10 will the point of bankruptcy occur.

But what if hospital costs increase so much over the long run, as many fear, that either HI benefits will have to be sharply reduced or what many believe to be unbearable HI tax rates will be required?

If the solution is to reduce benefit protection, the question then arises, how will the difference be made up? It is inconceivable that we will ration or refuse medical care of high quality to anybody. If Medicare does not meet a substantial portion of the cost, the burden will have to be borne by individuals, their former employers, and/or the government through Medicaid (i.e., by the general taxpayer).

It is easy to point out the extravagant and unnecessary medical care provided to others. But when you are the one involved, the situation looks quite different! Certainly, some greater efficiency and lower costs in the medical-care delivery system can be developed, but there is little room for significant improvement. Changes in the method of delivery—such as greater use of ambulatory surgical centers and requiring more second opinions as to surgery—will help to hold down rises in medical-care costs. However new beneficial, but costly, procedures will continue to be developed.

But what if the tax rates for OASDI and HI would have to rise to a very high level some 4 or 5 decades hence? This load would, of course, be unbearable if it went into effect in a few years. However, because the increase (if needed) would go into effect gradually, it could readily be borne by the working populace, and they would still have increasing real earnings, and thus a rising standard of living.

The explanation for this is that earnings will almost surely increase more rapidly than prices over the long-distant future, just as has occurred in the past. Part of this increase could be devoted to meeting the higher HI taxes. The benefit protection arising therefrom would represent an increase in the standard of living. The remainder of the increase in the real wages would result in a higher standard of living in areas other than retirement and health-care benefits.

Mr. CLAY. Thank you.

Dr. Andrews.

Ms. ANDREWS. Mr. Chairman, my name is Emily Andrews, and I'm research director at the Employee Benefit Research Institute [EBRI].

I'm very pleased to appear before this subcommittee during its consideration of the need for a national retirement income policy.

One of the issues that you have raised is the extent to which a national income policy should address the issue of pension coverage.

What I'd like to do is provide some information based on a survey that was sponsored by EBRI and by the Department of Health and Human Services in May of 1983. I plan to discuss four topics in my testimony today—who is covered by employer-sponsored plans, who is not covered by employer-sponsored plans, recent trends in employer-sponsored coverage, and what influences pension coverage.

EBRI was formed in 1978 as a nonprofit, nonpartisan, public policy research institute to conduct research and educational programs. My comments today are set within that framework. They should not be construed as endorsing any particular policy to either encourage or discourage coverage under employer-sponsored retirement plans.

To start, how prevalent are employer plans? Most nonfarm employees have told us that they work for an employer who sponsors some type of a pension or retirement plan. This is the concept that we call coverage.

Specifically, 56 percent of the 88 million nonfarm workers said they were covered under a plan in 1983. Among nonfarm workers age 25 to 64 working 1,000 hours per year who worked on their jobs at least 1 year—essentially the 1983 ERISA participation standards—70 percent were covered in 1983. Out of firms employing 500 or more workers, coverage was provided to 82 percent.

We also want to know how coverage is targeted. Most covered workers earn relatively modest salaries. Over 76 percent of all covered employees earned less than $25,000 a year.

Of course, as we know, not everyone has pension coverage. Noncovered workers can be divided up into five different categories. Fifteen percent of them are self-employed, and these workers appear to reinvest their savings into their own businesses instead of into pension plans.

Three percent of uncovered workers are in agriculture. These workers are seasonal and have many other employment problems.

Twenty-seven percent of uncovered workers are under age 25 or over age 65. The Retirement Equity Act [REA] is going to include about 583,000 additional younger employees in pension plans.

Workers without coverage who are on the job less than a year or who usually work less than 1,000 hours make up another 20 percent of the uncovered work force. Those that met all ERISA participation standards made up the remaining 35 percent of all uncovered workers, but these only represent 16 percent of the total employed population.

Noncovered workers who meet ERISA participation standards or those who could meet them soon are very different from covered workers. Consider four characteristics. The non-covered workers are much more likely to work in small firms with fewer than 100 employees. They're less likely to work under a union contact. They tend to have lower earnings and shorter job tenure.

In order to evaluate some of these coverage issues, we should also know how coverage has changed over the past few years and, ideally, why it has changed.

The coverage rate fell from 61 to 56 percent between 1979 and 1983. These declines took place in the private and public sectors. Declining coverage rates may have been caused by the 1982 recession and by the generally poor economic conditions that preceded that recession.

Economic expansion since then may have produced renewed growth in coverage. However, other evidence suggests that coverage may have been affected by post-ERISA legislation, such as the Economic Recovery Tax Act of 1981 [ERTA] and the tax Equity and Fiscal Responsibility Act of 1982 [TEFRA].

We're going to have to wait until we get statistics for 1984 and 1985 in order to determine whether legislation has slowed growth. In any event, very few are forecasting the type of robust growth that occurred before 1979.

In conclusion, whether an employee has employer-sponsored coverage depends on both characteristics of the workplace and on characteristics of the employees. One of EBRI's statistical analyses showed that the major difference in coverage rates stemmed from only two sources—firm size and unionization.

We found that small, unionized firms are more likely to provide coverage than are small, nonunionized firms. These figures suggest that if policies could be devised to increase the extent of coverage among small firms, many more workers would qualify for pension benefits at retirement. For instance, if firms with fewer than 100 workers were as likely to have a pension plan as were firms with 100 to 500 workers, then 7.6 million more employees would be covered, and 3.6 million of these would be vested.

Changes in coverage could have larger effects on pension receipts than changes in vesting and participation.

The challenge to all of us is to devise policies that will encourage coverage growth without producing other adverse indirect effects on workers and firms.

I hope that the information we're providing today can help you meet the challenge.

Thank you.

[Prepared statement of Emily S. Andrews follows:]

EBRI

T-42

Oral Statement on

Coverage Under Employer-Sponsored Plans

Before the U.S. House of Representatives
Committee on Education and Labor
Subcommittee on
Labor-Management Relations

Hearings on Employee Benefits and
the Need for a National Retirement Income Policy
March 21 and April 2 and 3, 1985

of
Emily S. Andrews
Research Director
Employee Benefit Research Institute

The views expressed in this statement are solely those of the author and should not be attributed to the Employee Benefit Research institute, its officers, trustees, sponsors, or other staff. The Employee Benefit Research Institute is a non-profit, non-partisan public policy research organization

Emily S. Andrews earned her Ph.D. in economics from the University of Pennsylvania. Before joining EBRI she held policy research positions at the Social Security Administration and the U.S. Department of Labor.

EMPLOYEE BENEFIT RESEARCH INSTITUTE
2121 K Street, NW / Suite 860 / Washington, DC 20037 / Telephone (202) 659-0670

INTRODUCTION

Mr. Chairman, my name is Emily Andrews. I am research director at the Employee Benefit Research Institute. I am pleased to appear before this Subcommittee during its consideration of the need for a national retirement income policy. One of the issues you have raised is the extent to which a national retirement income policy should address the issue of pension coverage. I would like to provide some information based on a survey sponsored by EBRI and the U.S. Department of Health and Human Services in May 1983. I plan to discuss four topics in my testimony today:

- Who is covered by employer-sponsored retirement plans;
- Who is not covered by employer-sponsored plans;
- Recent trends in employer-sponsored coverage; and
- What influences pension coverage.

EBRI was formed in 1978 as a non-profit, non-partisan, public policy research organization to conduct research and educational programs. My comments today are set within this framework. They should not be construed as endorsing any particular policy to encourage or discourage coverage under employer-sponsored retirement plans.

WHO IS COVERED BY EMPLOYER-SPONSORED RETIREMENT PLANS

To start, how prevalent are employer-sponsored plans? Most nonfarm employees tell us that they work for an employer who sponsors some type of pension or retirement plan. This is the concept we call coverage. Specifically, 56 percent of 88 million nonfarm workers said they were covered under a plan in 1983. Among nonagricultural employees age 25 to 64 working 1,000 hours or more who have worked on their jobs at least one year, 70 percent were covered in 1983. Firms employing 500 or more employees provided coverage to 82 percent of their employees (chart 3).

We also want to know how coverage is targeted. Most covered workers earn relatively modest salaries. Over 76 percent of all covered employees earned less than $25,000 a year in 1983.

WHO IS NOT COVERED BY EMPLOYER-SPONSORED PLANS

Of course, not everyone has pension coverage. Noncovered workers can be sorted into five categories (chart 1). Fifteen percent of uncovered workers are self-employed. These workers appear to reinvest their savings in their own businesses instead. Three percent of uncovered workers are in agriculture. These workers are seasonal and have any number of other employment problems. Twenty-seven percent of uncovered workers are under age 25 or age 65 and over. Through the Retirement Equity Act (REA) employers will include 583,000 additional younger employees in their pension plans.

Workers without coverage who were on the job less than a year or who usually worked less than 1,000 hours accounted for another 20 percent of all uncovered workers. Those who met all 1983 ERISA participation standards made up the remaining 34 percent of all uncovered workers. But, they only represent 16 percent of total employment.

Noncovered workers meeting ERISA participation standards (or who could expect to meet those standards) are different from those who are covered. Consider four important characteristics. Noncovered workers are much more likely to work in small firms with fewer than 100 employees (68 percent compared to 17 percent). They are less likely to work under a union contract (10 percent compared to 38 percent). Noncovered workers also tend to have lower earnings and shorter job tenure.

RECENT TRENDS IN EMPLOYER-SPONSORED COVERAGE

To evaluate the coverage issue, we need to know how coverage has changed over the past few years, and, ideally, why it has changed. The coverage rate fell between 1979 and 1983 among nonfarm workers from 61 percent to 56 percent. Declines took place among both private sector and government employees (chart 2).

Declining coverage rates may have been caused by the 1982 recession and generally poor economic conditions. Economic expansion since the May 1983 survey may have produced renewed growth in coverage. Other evidence suggests that coverage may have been affected by post-ERISA legislation such as ERTA and TEFRA. Statistics for 1984 and 1985 are needed to determine whether legislative change has reduced coverage growth. Few are forecasting the type of robust growth in pension coverage experienced before 1979.

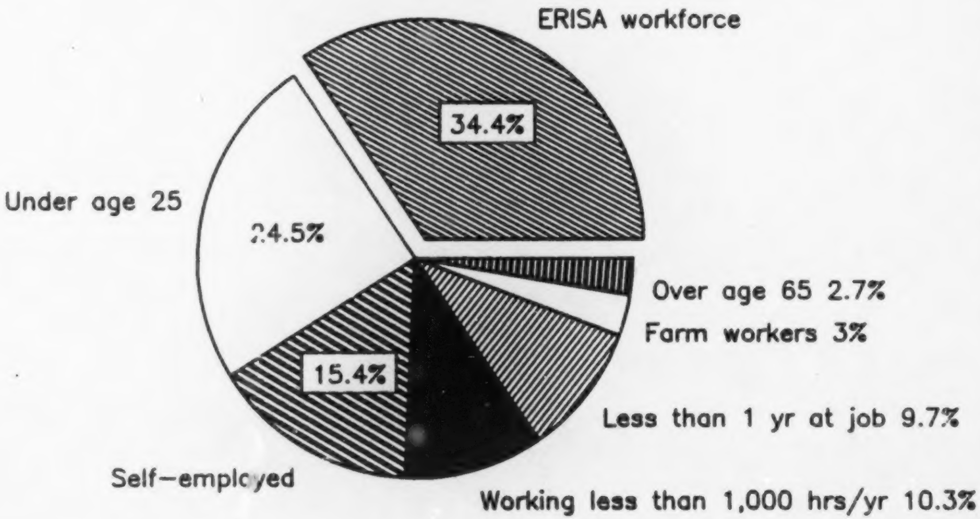
WHAT INFLUENCES PENSION COVERAGE?

Whether an employee has employer-sponsored coverage depends on the characteristics of the workplace and characteristics of the employee. A statistical analysis undertaken by EBRI shows that the major difference in coverage rates stems from only two sources -- firm size and unionization. Small firms that are unionized are more likely to provide coverage than small nonunionized firms.

These figures suggest that if policies could be devised which would increase the extent of coverage among small firms, many more workers would qualify for pension benefits at retirement. If firms with fewer than 100 workers were as likely to have a pension plan as firms with 100 to 500 workers, 6.8 million more employees would be covered; of these 3 million would be vested. Changes in coverage have much larger effects on pension receipt than changes in vesting and participation.

The challenge is to devise policies to encourage expanded coverage without producing adverse indirect effects on workers or firms. I hope the information we provide can help you meet that challenge.

Chart 1
Percent Distribution of Employees Lacking Pension Coverage
Across Employment Categories, May 1983



Note: "ERISA workforce" consists of all employees not included in other categories (employees meeting ERISA participation standards).

EBRI

T-42

Statement on

Coverage Under Employer-Sponsored Plans

Before the U.S. House of Representatives
Committee on Education and Labor
Subcommittee on
Labor-Management Relations

Hearings on Employee Benefits and
the Need for a National Retirement Income Policy
March 21 and April 2 and 3, 1985

of
Emily S. Andrews
Research Director
Employee Benefit Research Institute

The views expressed in this statement are solely those of the author and should not be attributed to the Employee Benefit Research institute, its officers, trustees, sponsors, or other staff. The Employee Benefit Research Institute is a non-profit, non-partisan public policy research organization

Emily S. Andrews earned her Ph.D. in economics from the University of Pennsylvania. Before joining EBRI she held policy research positions at the Social Security Administration and the U.S. Department of Labor.

EMPLOYEE BENEFIT RESEARCH INSTITUTE
2121 K Street, NW/Suite 860/Washington, DC 20037/Telephone (202) 659-0670

Summary of Statement of Emily S. Andrews
Research Director, Employee Benefit Research Institute

Who is Covered by Employer-sponsored Retirement Plans?

Coverage and vesting are broadly based. Most nonfarm employees work for an employer who sponsors some type of pension or retirement plan; 56 percent of 88 million nonfarm workers said they were covered under a plan. Many of these workers expect to receive benefits at retirement. Of the 50 million covered workers, 22 million or 45 percent are eligible for a pension. Another 6 million, or 13 percent of covered workers, expect to receive a lump-sum distribution from their plan when they leave their job. Employees who expect either type of vested benefit sum to 58 percent of covered workers.

Most covered workers earn relatively modest salaries. This finding seems contradictory since coverage rates increase with earnings. However, over 76 percent of all covered employees and 70 percent of all vested employees earn less than $25,000 a year.

Workers are more likely to be vested as they reach retirement age. Among workers age 60 to 64, 70 percent in the private sector have vested benefits and 88 percent of government workers are entitled to a pension or a lump sum distribution from their current job. Coverage from previous employment could increase retirement income. However, most employees (71 percent) spend lump sum distributions they receive before retirement instead of saving them.

Who is Not Covered by Employer-sponsored Plans

Noncovered workers can be sorted into five categories. Fifteen percent of noncovered workers are self-employed. These workers appear to reinvest their savings in their own businesses instead. Three percent of noncovered workers are in agriculture. These workers are seasonal and have a number of other employment problems. Twenty-six percent of noncovered workers are under age 25 or age 65 and over. Through the Retirement Equity Act (REA) employers will have to include 583,000 additional younger employees in their pension plans. Only time will tell whether more young workers will seek employers who provide pensions.

Workers without coverage who were on the job less than a year or who usually worked less than 1,000 hours account for another 20 percent of all noncovered workers. Those who met all 1983 ERISA participation standards make up the remaining 34 percent of all noncovered workers. They represent 16 percent of total employment.

Noncovered workers meeting ERISA participation standards (or who could expect to meet those standards) are different from those who are covered. Noncovered workers are more likely to work in small firms with fewer than 100 employees (68 percent compared to 17 percent). They are less likely to work under a union contract (10 percent compared to 38 percent). Noncovered workers also tend to have lower earnings and shorter job tenure.

Although individual retirement accounts were initially established through ERISA to help noncovered workers fill their pension gap, only 12 percent of noncovered workers contributed to an IRA in 1982 compared to 17 percent of all nonfarm employees.

Recent Trends in Employer-Sponsored Coverage

To evaluate the coverage issue, we need to know how coverage has changed over the past few years. The coverage rate fell between 1979 and 1983 among nonfarm workers from 61 percent to 56 percent. Declines took place among both private sector and government employees. Over the same period the relative fraction of covered workers who are women has increased.

Declining coverage rates may have been caused by the 1982 recession and generally poor economic conditions. An analysis by industry of workers meeting ERISA participation standards in 1983 shows the composition of the decline in greater detail. Some industries, like durables manufacturing, had losses in employment and in pension coverage. Others showed little change in employment and little if any coverage expansion. By contrast employment and coverage increased in the service sector and coverage rates remained relatively unchanged.

Economic expansion since the May 1983 survey may have produced renewed growth in coverage. Other evidence suggests that coverage may have been affected by post-ERISA legislation such as ERTA and TEFRA. Statistics for 1984 and 1985 are needed to determine whether legislative change has reduced coverage growth. Few analysts are forecasting the type of robust growth in pension coverage experienced before 1979.

Coverage rates fell for both men and women. But declining coverage affected men to a greater extent. The number of women workers grew between 1979 and 1983 while the number of men shrank. As a consequence, 39 percent of covered workers were women in 1979 compared to 42 percent in 1983. The coverage rate for women is still lower than that for men, however.

What Influences Pension Coverage?

Whether an employee has employer-sponsored coverage depends on the characteristics of the workplace and characteristics of the employee. A statistical analysis undertaken by EBRI shows that four factors more closely related to the employee-- age, hours of work, job tenure and wages -- account for 32 percent of the variation in coverage. Industry differences account for another 17 percent of the variation.

The major difference in coverage rates stems from only two sources -- firm size and unionization. Large firms, whether or not unionized, usually have pension plans. The coverage rate for firms with more than 500 employees is 82 percent. That for firms with fewer than 100 employees is 23 percent.

The coverage rate for private sector employees under a collective bargaining agreement is 82 percent; that for nonunionized employees is 44 percent. Small firms that are unionized are more likely to provide coverage than small nonunionized firms.

These figures suggest that if policies could be divised which would increase the extent of coverage among small firms, many more workers would qualify for pension benefits at retirement. EBRI simulations show that if firms with fewer than 100 workers were as likely to have a pension plan as firms with 100 to 500 workers, 6.8 million more employees would be covered; of these, 3 million would be vested.

The challenge is to devise policies to encourage expanded coverage without producing adverse indirect effects on workers or firms. I hope the information we have provided can help you meet that challenge.

STATEMENT

INTRODUCTION

Mr. Chairman, my name is Emily Andrews. I am research director at the Employee Benefit Research Institute (EBRI). I am pleased to appear before this Subcommittee during its consideration of the need for a national retirement income policy.

One of the issues you have raised is the extent to which a national retirement income policy should address the issue of pension coverage. To aid the Congress in its considerations on this subject, I would like to provide some information based on a survey of individuals sponsored by EBRI and the U.S. Department of Health and Human Services in May 1983. This survey provides the most comprehensive information on coverage available.

I plan to discuss four topics in my testimony today:

- Who is covered by employer-sponsored retirement plans;
- Who is not covered by employer-sponsored plans;
- Recent trends in employer-sponsored coverage; and
- What influences pension coverage.

EBRI was formed in 1978 as a non-profit, non-partisan, public policy research organization to conduct research and educational programs. EBRI is committed by charter to the premise that the nation is served in social and economic terms by the existence of employee benefit programs. We are aware that there may be limits to what can and should be provided. Consequently, EBRI undertakes to provide studies and statistics that will allow informed priority decisions to be made upon assessment of documented costs and benefits.

My comments today are set within this framework. They should not be construed as endorsing any particular policy to encourage or discourage coverage under employer-sponsored retirement plans.

WHO IS COVERED BY EMPLOYER-SPONSORED RETIREMENT PLANS

Pension coverage is widespread throughout the labor force.[1] Most nonagricultural wage and salary workers report working for an employer who sponsors some type of pension or retirement plan. This concept is generally referred to as pension coverage. In 1983, 56 percent of the 88 million nonagricultural wage and salary workers reported coverage under an employer-sponsored plan.

Another labor force group of relevance to the Congress consists of nonagricultural employees age 25 to 64 working 1000 hours or more who have worked on their jobs for at least a year. This group is called the "ERISA" work force because the workers meet ERISA standards for plan participation. The "ERISA" workforce is more likely to build up meaningful employment-based pensions at retirement. The coverage rate for these 56 million employees reached 70 percent in May 1983.

Many covered workers, whether or not they are in the "ERISA" workforce, expect to receive benefits at retirement. Of the 50 million covered nonagricultural wage and salary workers, 22 million or 45 percent said they would be eligible for a pension. Another 6 million, or 13 percent of covered workers, expect to receive a lump-sum distribution from their plan when they leave their job. Employees who expect either type of vested benefit -- a pension or a lump sum distribution -- sum to 58 percent of covered workers.

Those workers who comprise the "ERISA" workforce are even more likely to be vested in a pension plan. Of the 38 million covered workers in the "ERISA" workforce, 53 percent expect a pension when they reach retirement. Another 3 million workers expect to receive a lump sum distribution. This boosts the total vesting rate for the "ERISA" work force to 67 percent.

Coverage and Earnings

One of the primary public policy objectives in providing tax advantages to employer-sponsored plans has been to ensure that these benefits reach employees across the income spectrum. Employer-sponsored pensions are focused on workers in the middle of the earnings distribution..

Most studies have noted that the coverage rate increases strongly with earnings. Although the majority of workers in the middle of the earnings distribution are covered under a pension plan, coverage rates increase gradually from 58 percent for those earning between $10,000 and $14,999 to 79 percent for those earning between $20,000 and $25,000. Coverage rates approach 85 percent for those earning $50,000 and over.

Another way to examine the distribution of employees entitled to pension benefits is through statistics on the cumulative distribution of employment and coverage by earnings groups. Nearly 83 percent of all nonagricultural wage and salary workers earn less than $25,000 (table 1). Pension coverage and vesting follow this pattern with 76 percent of covered workers and 70 percent of those vested earning less than $25,000 yearly. This broad base of pension coverage and vesting is frequently obscured when differences in coverage rates between earnings groups are emphasized.

TABLE 1

EMPLOYMENT, COVERAGE AND VESTING: CUMULATIVE DISTRIBUTION FOR NONAGRICULTURAL WAGE AND SALARY WORKERS ACROSS EARNINGS GROUPS*, MAY 1983

	Cumulative Distribution across Earnings Groups		
	Employment	Coverage	Vesting
Total Employees (000s)	88,214	49,530	28,708
less than $5,000	12.5	5.1	1.3
less than $10.000	31.6	17.3	8.6
less than $15,000	53.8	39.1	28.5
less than $20,000	70.0	59.0	49.8
less than $25,000	82.8	76.2	70.2
less than $30,000	89.8	85.4	81.2
less than $50,000	[illegible]	97.1	96.0
Total Earnings	100.0%	100.0%	100.0%

*Percentages exclude 9.0% of employees whose earnings are not reported.

Coverage and Age

Workers are more likely to become vested as they reach retirement age. Among nonagricultural wage and salary workers age 60 to 64, 70 percent in the private sector have vested benefits and 88 percent of government workers are entitled to a pension or a lump sum distribution from their current job. Government workers are much more likely to expect only a lump sum distribution, however. Even among those workers age 60 to 64 years of age, 12 percent of government workers expect to receive only a lump sum distribution compared to 5 percent of employees in the private sector.

Coverage from previous employment could also increase retirement income. In 1983, 18 percent of the "ERISA" workforce, or about 10 million employees reported coverage under an employer-sponsored pension on an earlier job. About 6.6 million had either cashed out their benefits through a lump-sum distribution or were entitled to retirement benefits.

Over 70 percent of all employees receiving preretirement cash outs spent these distributions instead of saving them (table 2). The uses individuals make of preretirement distributions are strongly affected by the amount of the cash out. Eighty-seven percent of those receiving over $20,000 saved their retirement funds. Only 26 percent of those receiving less than $5,000 added these distributions to their savings. In sum, a substantial portion of benefits provided by employer-sponsored plans before retirement are never translated into retirement income.

Table 2

The Use of Preretirement Lump-Sum Distributions
by Purpose and Amount
(as Reported May 1983)

	Total	less than $5,000	$5,000 - $9,999	$10,000 - $19,999	Over $20,000
TOTAL RECIPIENTS[a] (000's)	6,594	5,533	583	218	154
Percent Distribution[a]	100.0%	84.2%	8.9%	3.3%	2.3%
ALL USES[b]	100.0%	100.0%	100.0%	100.0%	100.0%
Total Saving	32.0%	26.0%	57.6%	78.9%	87.3%
Retirement Program	4.4	2.4	*	*	*
Insurance Annuity	*	*	*	*	*
Housing Purchase	10.1	9.3	12.5	*	*
Other Investment	16.8	14.0	29.9	45.9	*
Total Consumption	71.4%	76.6%	51.9%	42.6%	*
Car Purchase	4.8	4.8	*	*	*
Vacation	3.2	3.1	*	*	*
Other Use	63.4	68.7	40.9	*	*

[a] Recipients by lump sum amount are less than total recipients and percentages are less than 100 percent because of the omission of "don't know" and "no response" to the survey question on the value of the lump-sum distribution.

[b] Percentages may add to over 100 percent because recipients may have used lump sum distribution in more than one way.

* Number of workers too small for rates to be calculated reliably.

WHO IS NOT COVERED BY EMPLOYER-SPONSORED PLANS

Not all workers are covered by an employer-sponsored plan. Noncovered workers can be sorted into five categories (chart 1). Fifteen percent of non-covered workers own their on businesses. These self-employed workers can provide retirement protection for themselves and their employees through Keogh plans and individual retirement accounts. The most frequent explanation for low rates of pension coverage among the self employed is that they reinvest their excess funds in their own businesses.

Three percent of noncovered workers are in agriculture. Their coverage rate is the lowest of all noncovered groups at just over 10 percent. Many agricultural employees are low-wage seasonal workers, employed on more than one farm. They frequently face a complex set of other labor market problems.

Nearly 25 percent of all noncovered workers in 1983 were under 25 years of age. This age group was not subject to ERISA particiption standards according to the 1974 law. Young workers are more likely to have short years of service and to work part-time schedules. EBRI has estimated that lowering the minimum age standard through the Retirement Equity Act will mean that sponsoring employers will have to include an additional 583,000 young employees in their pension plans.[2] Only time will tell whether many more young workers will seek employers who provide pension plans as well.

Workers 65 years of age an older are also a special case; 2.7 percent of all noncovered workers fall in this group. ERISA states that defined benefit plans may exclude all new employees within 5 years of normal retirement age. Furthermore, benefit accruals generally only continue to the normal retirement age (usually age 65).

Chart 2
Percent of Non–Farm Workers with Pension Coverage, by Sector, May 1979 and May 1983

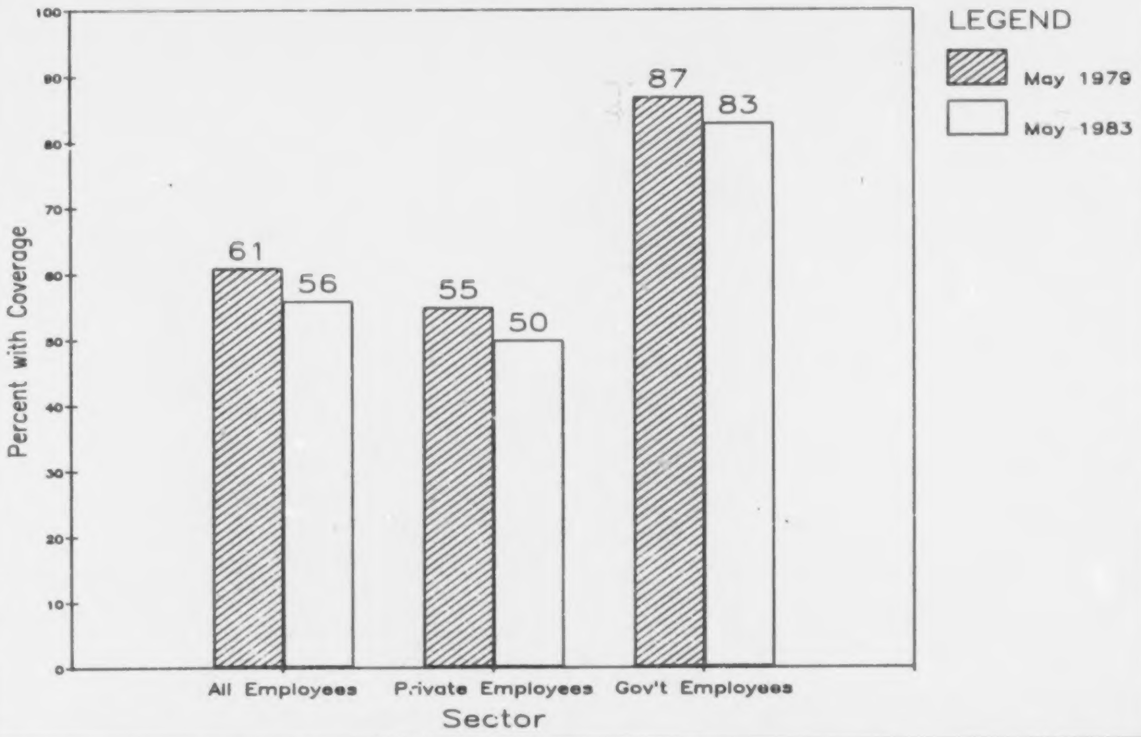
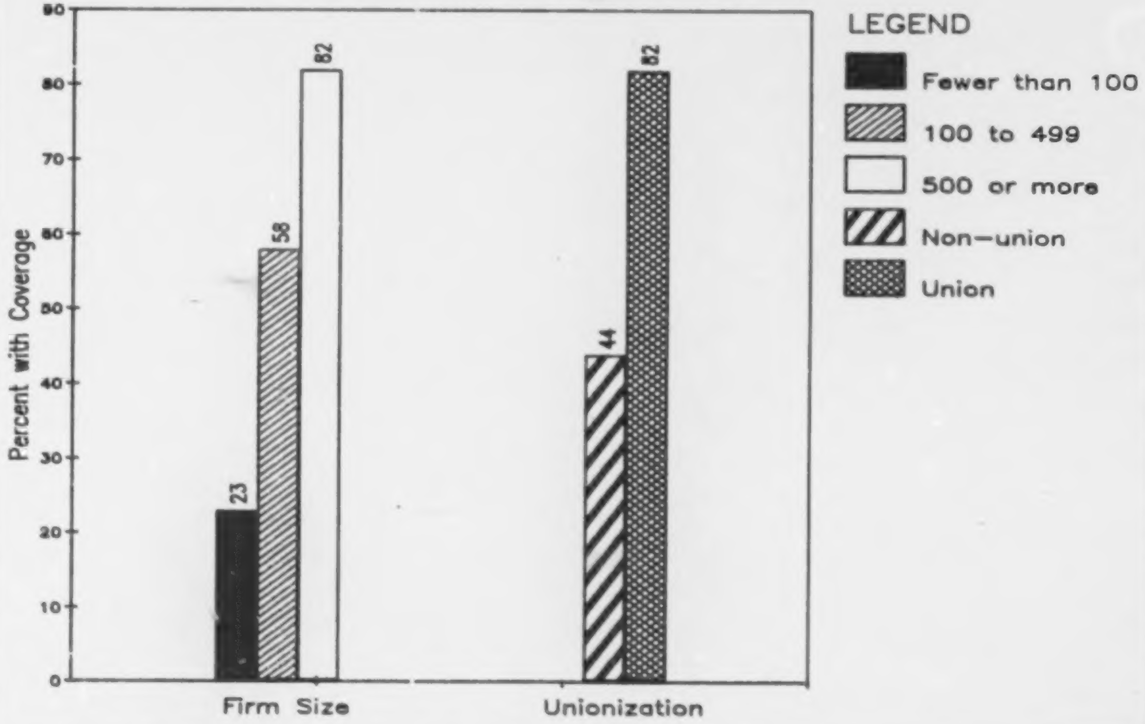


Chart 3

Percent of Non-Farm Private Employees with Pension Coverage, by Firm Size and Unionization, May 1983



Workers without coverage who were on the job less than a year or who usually worked less than 1,000 hours accounted for another 20 percent of all noncovered workers. ERISA standards state that pension plans only need credit a year of service to employees who work 1,000 hours or more under the plan.

Those workers meeting all 1983 participation standards made up the remaining 34 percent of all noncovered workers. But, they only represent 16 percent of total employment. A more generous definition of the core of the coverage problem in 1983 would include workers who met all the 1974 ERISA participation standards except for job tenure. Most of these workers will become part of the ERISA work force if they remain on their job for a year. In this case -- which we will call the "near-ERISA" workforce-- the core coverage problem consists of 21 million workers or 21 percent of the labor force.

Characteristics of Noncovered Workers

Noncovered workers in the "near-ERISA" work force differ from those who are covered (table 3). Noncovered workers are much more likely to work in small firms with fewer than 100 employees (68 percent versus 17 percent of covered workers). They are less likely to work under a union contract. Noncovered workers also tend to have lower earnings and shorter job tenure. About 35 percent of noncovered "near-ERISA" workers earn less than $10,000, compared to only 10 percent of all covered workers.

Many of the noncovered workers employed by small firms also have low incomes. Thirty-seven percent of all noncovered workers in firms with fewer than 100 employees earn less than $10,000, and 72 percent of all low-income

TABLE 3

THE DISTRIBUTION OF COVERED AND NONCOVERED WORKERS
IN THE "NEAR-ERISA" WORKFORCE
AGES 25 THROUGH 64 WORKING 1000 HOURS OR MORE
BY SELECTED CHARACTERISTICS, MAY 1983

	Covered Workers (000's)	Distribution Across Groups	Workers Not Covered[a] (000's)	Distribution Across Groups
FIRM SIZE[b]				
Less than 100 employees	6,215	17.4%	12,352	68.1%
100 to 499 employees	5,545	15.6	2,465	13.6
500 or more employees	23,869	67.0	3,314	18.3
Total	40,702	100.0	20,894	100.0
UNION STATUS				
Union	15,223	38.2	2,163	10.6
Nonunion	24,627	61.8	18,155	89.4
Total	40,702	100.0	20,894	100.0
EARNINGS[d]				
Less than $10,000	4,107	10.4	6,711	34.6
$10,000 to $24,999	24,545	62.1	10,374	53.5
$25,000 or more	10,866	27.5	2,309	11.9
Total	40,702	100.0	20,894	100.0
AGE				
Less than 35	14,588	35.8	9,095	43.5
35 and over	26,133	64.2	11,800	56.5
Total	40,702	100.0	20,894	100.0
HOURS				
Less than 2000	7,525	18.5	5,481	26.2
2000 and over	33,176	81.5	15,413	73.8
Total	40,702	100.0	20,894	100.0
SEX				
Women	16,335	40.1	9,932	47.5
Men	24,367	59.9	10,963	52.5
Total	40,702	100.0	20,894	100.0
TENURE[e]				
Less than 5 years	10,613	28.0	8,328	51.3
5 to 9 years	9,734	25.7	3,958	24.4
Ten years and over	17,518	46.3	3,830	23.6
Total	38,017	100.0	16,116	100.0

---

[a] Includes workers with no coverage, workers who do not know whether they have coverage and workers with no coverage information reported.

[b] Percentages exclude 12.7 percent of employees for whom firm size is not known.

[c] Includes workers who are not covered by a union contract, workers who do not know whether they are covered under a union contract, and workers with no reported information on unionization.

[d] Percentages exclude 4.4 percent of employees whose earnings are not reported.

[e] Total excludes 11.2 percent of employees who have worked at their current job for less than one year, doesn't include d/r.

SOURCE: Preliminary tabulations of EBRI/HHS May 1983 CPS pension supplement.

workers without coverage are employed by small firms. Nonetheless, 7 million workers or 63 percent of noncovered workers in small firms earn $10,000 or more.

The Use of Individual Retirement Accounts

ERISA instituted individual retirement accounts (IRAs) as a means of saving for retirement.[3] Contributions could be made to these accounts on a tax deferred basis until retirement age. About 4.4 percent of eligible noncovered nonagricultural wage and salary workers took advantage of this option in 1978.

The 1981 Economic Recovery Tax Act (ERTA) expanded IRA participation to virtually all workers. While it is not clear whether the wider visibility of IRAs led to greater IRA usage among noncovered workers, their IRA participation rate for 1982 rose to 12.3 percent of all noncovered employees. The 17 percent IRA participation rate for all nonfarm employees in 1982 was higher than that for noncovered workers. Lower use rates may simply be a result of lower earnings among noncovered workers. IRA usage among noncovered workers is certainly not higher than average, however.

IRA usage among covered workers may be boosted by the availability of payroll deduction plans and employer-sponsored IRAs. When IRAs are offered at the workplace, more employees take advantage of this option than otherwise. Usage among private nonagricultural wage and salary workers at 27 percent is higher that the 15 percent rate posted by employees whose employer does not offer an IRA.

RECENT TRENDS IN EMPLOYER-SPOSORED COVERAGE

Between 1979 and 1983, two trends in coverage are apparent. The first is the overall decline in the coverage rate among nonagricultural wage and salary workers from 61 percent in 1979 to 56 percent in 1983. Declines took place among both private sector and government employees (chart 2). This trend is emerges from other statistics as well. Another monthly measure of the prevalence of pensions among employees was collected by the Census Bureau between 1979 and 1983 as part of the March supplement to the Current Population Survey for all persons employed at any time during the previous year. It indicates gradual reductions in the number of workers who have been participants in a pension plan for each and every year. (Participants are workers whose employer sponsors a plan and who are included in that plan.)

The second trend is the increase in the relative proportion of women among covered workers. Although coverage rates fell for both men and women, declining coverage affected men to a greater extent. The number of women workers grew between 1979 and 1983 while the number of men shrank. As a consequence, 42 percent of covered workers were women in 1983 compared to 39 percent in 1979. The coverage rate for women (52 percent) is still lower than that for men (59 percent).

Industrial Changes and Pension Coverage

The severe 1982 recession and generally poor economic conditions may well have caused declining pension coverage rates between May 1979 and May 1983. Pension coverage rates will fall if employment losses are driven by layoffs in large unionized firms; and postrecessionary pension coverage will rebound. Employment losses resulting from permanent separations in large unionized firms will also lead to falling coverage rates. These losses will not be made up, however. Pension coverage rates may also fall in industries with employment growth if employers postpone establishing new pension plans.

Older industries appear to have been strongly affected by layoffs and permanent separations. The proportion of employees working for large firms decreased and unionization declined. Employers may have postponed establishing new plans in the service sector during the recession causing coverage growth to stagnate.

Declines in employment during the 1982 recession reinforced many of the long-term shifts away from certain sectors of durables manufacturing. Some nondurable goods manufacturing industries, such as chemicals and apparel, also suffered employment losses during the 1982 recession. In many cases the number of covered workers was reduced and coverage rates fell. Employment and pension coverage in the service-producing industries expanded between 1979 and 1983, however. In some sectors, the number of covered workers did not keep pace with employment growth and coverage rates fell. In other sectors, including professional services and financial services, coverage expanded at about the same pace and rates remained relatively constant.

Economic expansion since the May 1983 survey may have produced renewed growth in coverage. But new statistical evidence on plan growth also suggests that coverage may be affected by post-ERISA legislation such as Economic Recovery Tax Act (1981), Tax Equity and Fiscal Responsibility Act (1982), the Tax Reform Act of 1984 and the Retirement Equity Act (1984). The Census Bureau's March statistics on participation for 1984 and 1985 are needed to help determine whether legislative change has reduced coverage growth. These will not be available until late 1985 and late 1986, however, because of interview and processing schedules. Until the evidence proves otherwise, few analysts are forecasting the type of strong growth in pension coverage experienced before 1979.

Changes in Coverage for Women

Continuing concern about the low retirement income received by many older women today was one of the factors which led to the passage of the 1984 Retirement Equity Act. Lower coverage and vesting rates for women were cited as reasons for legislation. Among nonagricultural wage and salary workers in 1983, 59 percent of all men were covered by a pension plan compared to only 52 percent of all women. About 50 percent of all men covered by a pension plan were entitled to benefits at retirement compared to 38 percent of women. While these figures are higher for the "ERISA" workforce, significant gaps in coverage and expected benefit receipt remain. But these gaps have been closing slowly.

The one constant development for women in the workplace over the past 10 years has been that of change. The percentage of women 20 years of age and older working at paid employment grew by nearly 10 percentage points from 43 percent in 1970 to 53 percent in 1983. These gains occurred while the male labor force participation rate gradually declined with increasing college enrollment and earlier retirement. Women make up a larger and larger proportion of the workforce and more women work full-time schedules.

Despite the 1982 recession, women made considerable employment gains between May 1979 and May 1983. An additional 3.3 million women were employed as nonagricultural wage and salary workers. By contrast, male employment edged downward by 278,000 employees in response to the most severe recession since World War II.

Women's employment gains were translated into improvements in coverage and vesting. The number of female wage and salary earners covered by a pension plan increased by 660,000 workers, while the number of women entitled to future retirement benefits jumped by 1.2 million as more women accrued the necessary years of service to qualify for vesting.

WHAT INFLUENCES PENSION COVERAGE?

Whether an employee has employer-sponsored coverage depends on the characteristics of the workplace and the characteristics of the employee. As we have seen, some workers are more likely than others to be covered by an employer-sponsored plan. A number of statistical techniques are available which show the impact of differences in one factor from the effects of other related factors. We have used one technique called "analysis of variance" to determine which characteristics are the most important determinants of differences in pension coverage among private sector employees. According to a specification which determines the independent effect of each set of characteristics, those factors related to ERISA participation standards--age, hours of work and job tenure--were found to explain 16 percent of the variation in pension coverage among employees. Differences in wage rates were found to explain 16 percent of the variation and industry differences explained 17 percent.

By contrast, firm size combined with the effect of unionization at different firm size explains 52 percent of the variation in coverage. Eighty-two percent of private sector employees working for firms with more than 500 employees have pension coverage. This drops to 23 percent in small firms employing 99 or fewer workers. The coverage rate for private sector employees under a collective bargaining agreement is 82 percent; that for nonunionized employees is 44 percent (chart 3).

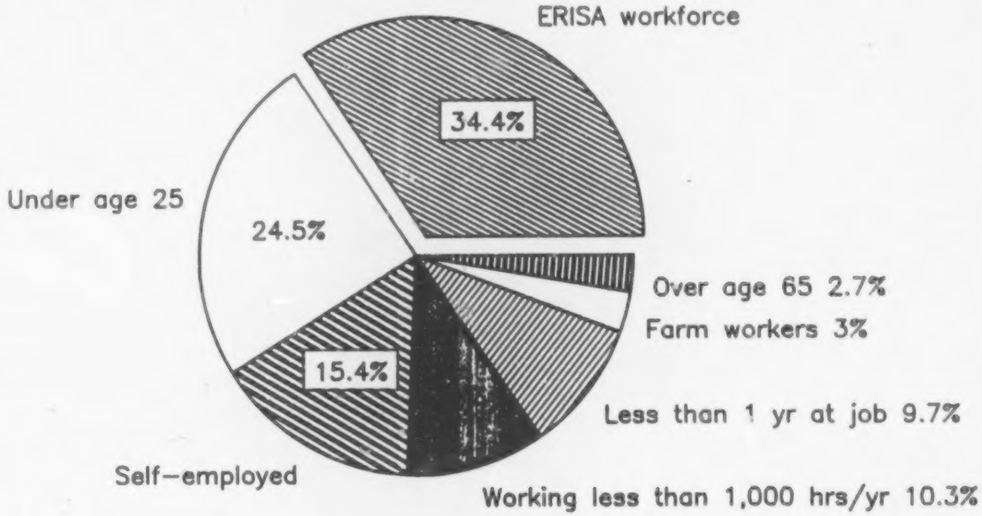
Small, nonunionized firms are less likely to establish pension plans. Simple statistics also can be used to demonstrate this fact as well. Less than 10 percent of workers in firms with less than 100 employees are unionized. Seventy-two percent of unionized workers in firms with less than 500 employees are covered by a pension plan, compared to only 28 percent of nonunion workers in such firms. The difference in coverage between unionized and nonunionized firms diminishes as the size of the firm increases. In the case of larger corporations, the difference is quite small. The most likely explanation for the effect of unionization on coverage is the ability of multiemployer plans to bring economies of scale into pension investment and administration.

The Potential Effect of Policy Changes

EBRI statistics suggest that if policies could be devised which would increase the extent of coverage among small firms, many more workers would qualify for pension benefits at retirement. If firms with fewer than 100 workers were as likely to have a pension plan as firms with 100 to 500 workers, 6.8 million more employees would be covered; of these 3.0 million

Chart 1

Percent Distribution of Employees Lacking Pension Coverage
Across Employment Categories, May 1983



Note: "ERISA workforce" consists of all employees not included in other categories (employees meeting ERISA participation standards).

Chart 2

Percent of Non-Farm Workers with Pension Coverage, by Sector, May 1979 and May 1983

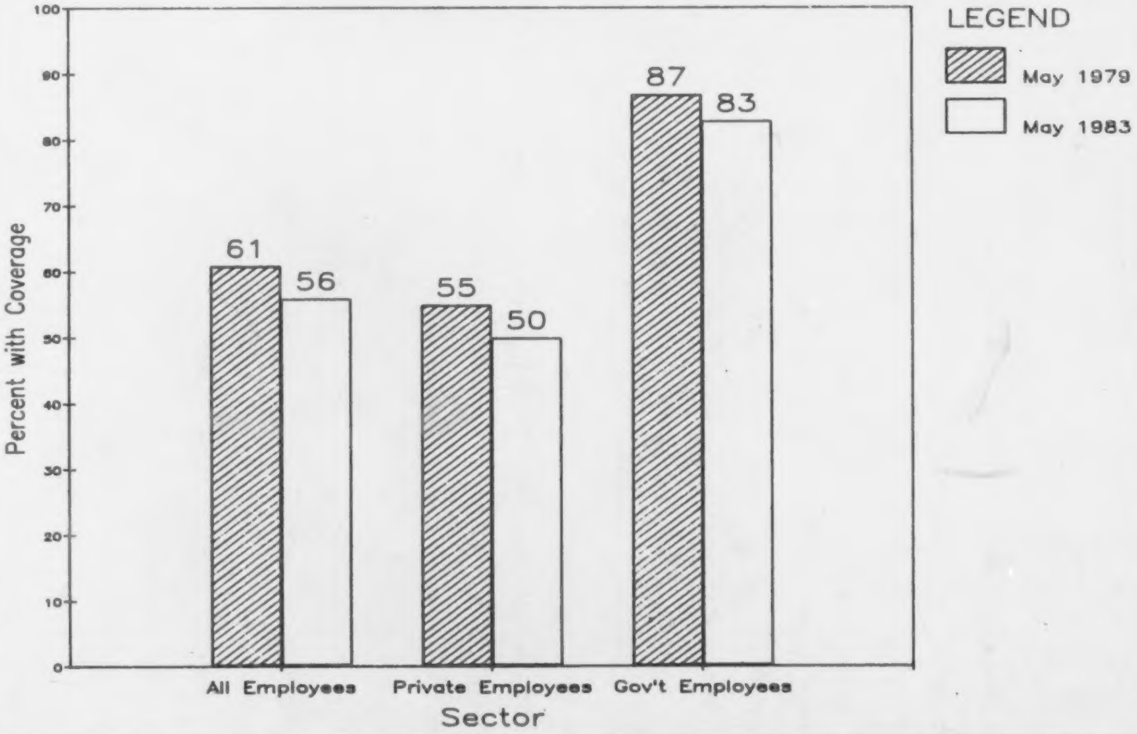


Table 4

Estimated Changes in Coverage, Participation and Vesting
if Smaller Firms Provided Coverage
to the Same Extent as Larger Firms
1985

If Firms with Fewer Than 100 Workers Had[a] Coverage Rates of Firms with 100 to 500 Workers	
Increased numbers of Older Workers (000's)	
Covered Workers	6,814
Participants	4,376
Vested Workers	2,992
If Firms with 100 to 500 Workers Had[b] Coverage Rates of Firms with over 500 Workers	
Increased numbers of[d] Older Workers (000's)	
Covered Workers	2,248
Participants	1,298
Vested Workers	837

[a] Estimates of increase in coverage for firms with less than 100 workers based on a simulated increase in the rate of covered workers to employees from 28.8 to 51.0 percent. The ratio of participants to covered workers declines from 75.5 to 69.9 percent in the simulation and ratio of vested workers to participants increases from 74.2 to 74.7 percent. These changes are applied to imputed data on pension status to best represent actual numbers of participants and vested workers in 1983. These figures are brought forward to 1985 by assuming a 10.0 percent gain in employment over the 1983 simulation.

[b] Estimates of increase in coverage for firms with 100 to 500 workers based on a simulated increase in the rate of covered workers to employees from 62.6 to 82.9 percent. The ratio of participants to covered workers declines from 74.8 to 70.6 percent in the simulation and ratio of vested workers to participants declines from 72.5 to 71.0 percent. These changes are applied to imputed data on pension status to best represent actual numbers of participants and vested workers in 1983. These figures are brought forward to 1985 by assuming a 10.0 percent gain in employment over the 1983 simulation.

would be vested (table 4). If firms with 100 to 500 employees were as likely to have a pension plan as firms with over 500 workers, there would be 2.2 million more covered workers and 837,000 more vested workers. These estimates are based on ERISA participation standards before the Retirement Equity Act. REA changes in participation would increase vesting in small plans even more as some workers under age 25 would be vested.

If increased coverage could be obtained it would be a more effective way to increase pension receipt than many other policy options being discussed. For instance, increasing coverage among plans with fewer than 100 workers would add over 60 percent more vested workers than five-year vesting. Five-year vesting would include more additional vested workers than a combination of expanded participation options including the recently enacted Retirement Equity Act, proposals to include more part-time workers and proposals to include older workers within 5 years of retirement. If the likelihood of coverage among firms with 100 to 500 workers could increase to that of the largest firms, the number of new vested workers would virtually equal the effect of a shift to seven-year vesting.

This does not imply that issues other than coverage are not important. There has been recent policy interest in other areas covered by ERISA such as post-65 accruals,[5] vesting standards[6] and pension integration. Nonetheless, effective policy to improve coverage would increase pension protection to the greatest extent. The issue, of course, is how could even a partial shift be accomplished.

IRAs were the first suggestion. They have not substantially increased coverage among noncovered workers. Another suggested remedy to increase coverage in small firms was the mandatory pension system proposal made by the

President's Commission on Pension Policy. According to that proposal all employers would have to contribute a minimum of 3 percent of payroll onbehalf of all employees over the age of 25 with one year of service and 1,000 hours of employment. Objections to this proposal ranged from concerns about market regulation and individual choice to concerns about the potential negative effects on the economy, in general, and on small businesses in particular. Additionally, it was pointed out that this would only have helped the 34.4 percent of noncovered persons residing in the ERISA workforce (see Chart 1).

The challenge is to devise policies to encourage expanded coverage without producing adverse indirect effects on workers or firms. The Congress will have to decide what level of retirement program coverage it thinks is desirable, and feasible, and at what price to employers, employees, and the federal government. I hope the information we have provided can help you meet that challenge.

NOTES

1. See "New Survey Findings on Pension Coverage and Benefit Entitlement," EBRI Issue Brief 33, August 1984.

2. See "Impact of Retirement Equity Act," EBRI Issue Brief 39, February 1985.

3. See "Individual Retirement Accounts: Characteristics and Policy Implications," EBRI Issue Brief 32, July 1984.

4. Scale economies in multiemployer plans are explored in Olivia S. Mitchell and Emily S. Andrews, "Scale Economies in Private Multi-Employer Pension Systems," Industrial and Labor Relations Review 34 (July 1981): 522-530.

5. See "Pension Accruals for Older Workers," EBRI Issue Brief 35, October 1984.

6. A more extensive discussion of the impact of various policy proposals, including quicker vesting, will be found in Emily S. Andrews, The Changing Profile of Pensions in America (Washington, D.C.: EBRI, forthcoming 1985).

EBRI NEWS

EMPLOYEE BENEFIT RESEARCH INSTITUTE • 2121 K Street, NW/Suite 860/Washington, DC 20037

CONTACT: Frank McArdle (202) 659-0670
Emily Andrews (202) 463-8148

FOR RELEASE: April 3, 1985

Pension Coverage Broad--But Not Among Small Firms

WASHINGTON, DC--Most nonfarm employees work for employers who sponsor a pension plan other than Social Security, but some gaps in pension coverage persist, Dr. Emily Andrews, EBRI research director, told the House Labor/Management Subcommittee, at hearings on a national retirement income policy. Fifty million (56%) of the 88 million nonfarm workers were covered under a pension plan, in a nationwide survey sponsored by the Employee Benefit Research Institute (EBRI) and the U.S. Department of Health and Human Services in 1983, the most recent survey available on the pension system.

Whether an employee has pension coverage depends on the characteristics of the work place and characteristics of the employee, Andrews said. A statistical analysis done by EBRI shows that major differences in pension coverage rates stem from two factors: firm size and unionization. Small firms that are unionized are more likely to offer pension coverage than small nonunionized firms. If polices could be devised to increase coverage among small firms, many more workers would qualify for pension benefits at retirement. If firms with fewer than 100 workers offered pension coverage as often as firms with 100-500 employees, for example, nearly 7 million more workers would be covered by a pension plan. Twenty-eight percent of employees in firms with fewer than 100 workers have pension coverage, compared to 58 percent in firms with 100-500 employees, and 82 percent in firms with more than 500 workers.

Workers not by pensions are frequently self-employed (15% of noncoverage), or working in agriculture (3% of noncoverage). Or, they may fall outside the age and extent of employment boundaries set down in the 1974 Employee Retirement Income Security Act. Under ERISA, the decision to offer a pension plan is a voluntary decision of the employer, but once an employer chooses to establish a pension plan, ERISA sets minimum age, participation, and vesting standards. In 1983, 27 percent of noncovered workers were under ERISA's minimum (then age 25) or maximum (usually age 65) standard; another 20 percent of noncovered employees worked for the employer less than a year or for less than 1,000 hours in a year. The remaining 34 percent of noncovered workers met the standards laid down in ERISA but were more likely to work in small firms, have lower earnings, shorter job tenure, and were less likely to be working under a union contract. Only one of out every eight workers not covered by a pension plan contributed to an Individual Retirement Account.

Pension coverage of nonfarm workers dropped from 61% in 1979 to 56% in 1983, probably because the survey was taken before employment had recovered from the worst recession in postwar history. Economic expansion since the May 1983 survey may have produced renewed growth in pension coverage, but few analysts predict a return to the robust growth in pension coverage before 1979. In part, Andrews suggested, the slowdown in coverage growth may be related to a spate of recent laws making pension plans less attractive for employers to establish and maintain.

EBRI is a nonprofit, nonpartisan, public policy research organization based in Washington, DC. Copies of the testimony are available through EBRI.

/attachment

Chart 3

Percent of Non–Farm Private Employees with Pension Coverage, by Firm Size and Unionization, May 1983

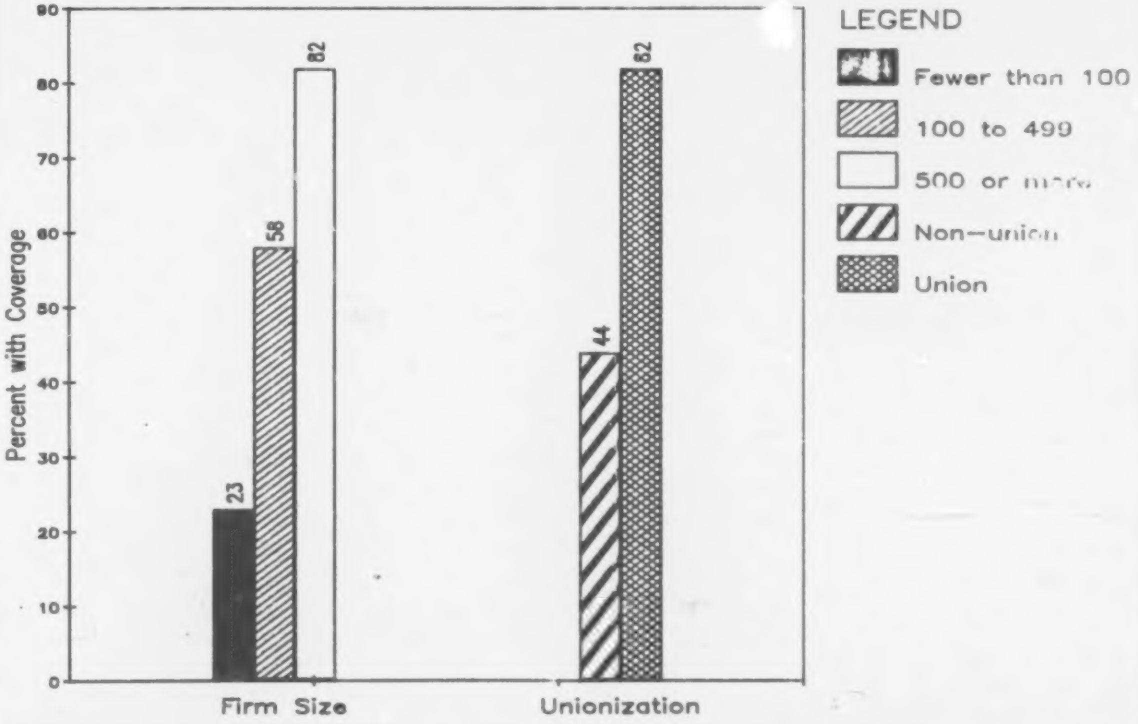
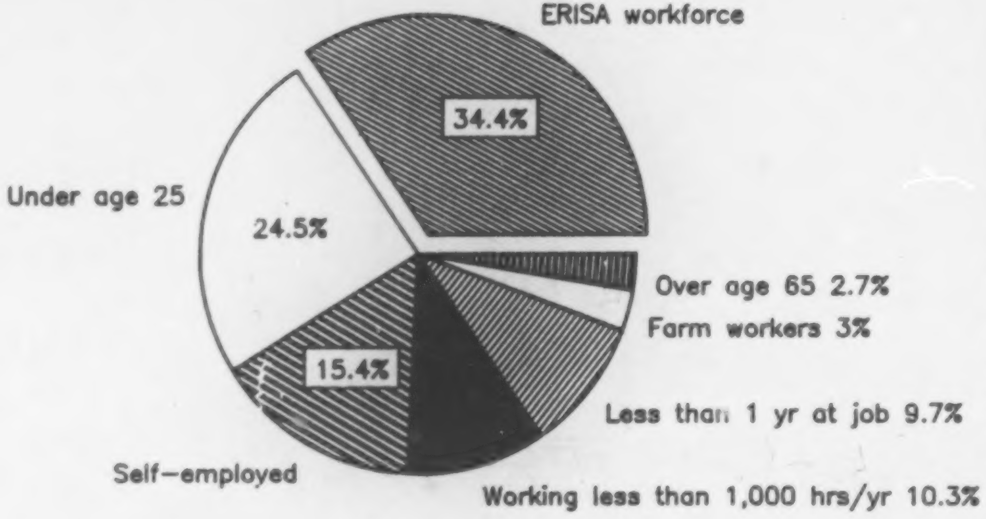


Chart 1

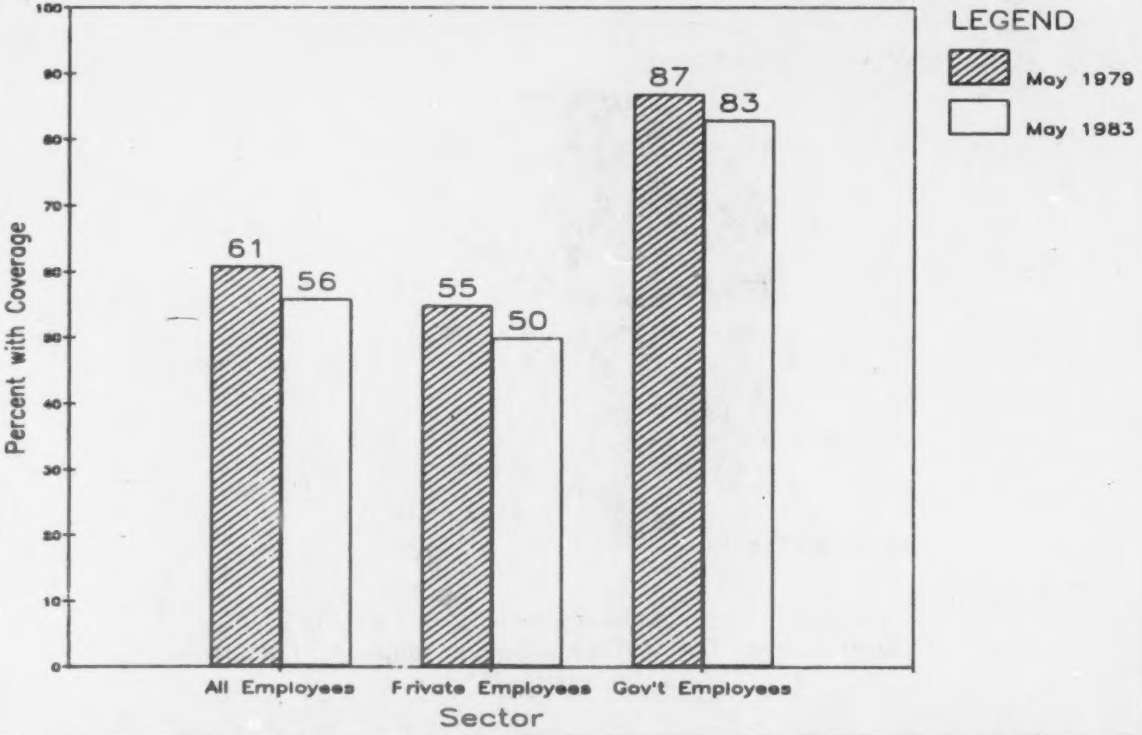
Percent Distribution of Employees Lacking Pension Coverage Across Employment Categories, May 1983



Note: "ERISA workforce" consists of all employees not included in other categories (employees meeting ERISA participation standards).

Chart 2

Percent of Non-Farm Workers with Pension Coverage, by Sector, May 1979 and May 1983



Mr. CLAY. Thank you.

Doctor, how can we broaden participation of lower-income workers in the private pension system and increase the likelihood of their receiving benefits?

Ms. ANDREWS. I think increasing coverage is a very difficult policy issue, and we're not prepared to say that one policy or another is going to work. However, I think it's more difficult to produce coverage for lower-income workers, for part-time workers, and for workers who go in and out of the labor force than it is to try to focus coverage on the ERISA work force.

We spoke about the minimum universal pension system [MUPS] policy before, and new policy suggestions have ranged from MUPS to IRAs, and I think that in each of these suggestions you have to weigh the costs and benefits of the suggestions before making a policy decision.

Mr. CLAY. Well, when you mention part-time—now, we have some people who are career part-time, and of course they ought to be entitled to some kind of benefits and retirement, too. How would a national policy deal with them, or what should we do to deal with that sector?

Ms. ANDREWS. Once again, I hate to say what we should do, but I can tell you some of the findings of our survey data. Many career part-time employees work over 1,000 hours, they meet ERISA standards, and they tend to be covered to a greater percent. I've done some simulations with which, if you'd like, I could provide you.

Mr. CLAY. We would like.

[The information referred to follows:]

Coverage rates for nonagricultural private sector employees vary by annual hours worked. Part-time workers are less likely to be covered than full-time workers. In 1983 the coverage rate for employees who worked 2,000 hours or more reached 64 percent of employment. The coverage rate for part-time workers employed 1,000 to 1,999 hours annually was somewhat lower at 51 percent. That for part-time workers working 500 to 999 hours was considerably lower at 31 percent.

Full-time workers were more likely to be entitled to benefits at retirement than part-time workers. Forty-nine percent of covered employees working 2,000 hours or more said they would be entitled to a pension at retirement. Among covered workers working 500 to 999 hours annually, 38 percent were entitled to future retirement benefits. The entitlement rate fell to 18 percent for those working 1,000 hours a year or less. Entitlement rates were lower for part-time workers because with they were less likely to be plan participants and because with fewer years of tenure on the job, they were less likely to meet plan vesting standards.

Ten percent of private nonagricultural employees working 500 to 999 hours annually worked for their employer for 10 years or more. (Many plans have 10 year cliff vesting.) Of those employees with 10 years of tenure, 49 percent worked for an employer with a pension plan and 55 percent of those covered were entitled to future benefits. By contrast, only 29 percent of workers with fewer than 10 years of tenure were covered under a plan and only 11 percent of those covered were entitled to future benefits.

The number of additional participants and vested workers who would be added to the workforce in 1985 if ERISA participation standards were lowered was simulated using an econometric model. Lowering the ERISA minimum hours requirement added 197,000 new plan participants. (The simulation is based on preREA conditions and does not simultaneously adjust for liberalized participation standards for younger workers.) We do not know whether more part-time workers would be encouraged to seek employers who sponsor pension plans.

The new participants would have lower job tenure than those already participating in pension plans. Under current ERISA standards, 63 percent of all participants in 1985 working 500–999 hours annually would qualify for vested benefits (including possible lump-sum distributions). If the minimum hours standard were to be liberalized in 1985, 58 percent of all participants working 500 to 999 hours would be vested. A reduction in the minimum ERISA hours standard would provide vested benefits to an additional 91,000 workers. This represents a 21 percent increase in the number of vested workers working 500 to 999 hours annually. It only represents 2 percent of all nonagricultural employees working these hours.

Ms. **Andrews**. These simulations suggest that many employees who work between 500 and 1,000 hours and who have had many years on the job are covered to a greater extent than those employees who have fewer years on the job working similar part-time hours.

Mr. **Clay**. Thank you.

Mr. Chandler.

Mr. **Chandler**. First of all, let me just say, Dr. Andrews, how enormously helpful the EBRI information is to all of us as we deal with this subject.

Having had the experience of being a small start-up company, I have a good feel for the decision that employers make when they're determining their compensation policy.

The question that I have would be, what would your opinion be of the impact on total compensation if we had a policy which required some type of coverage?

Let me lead the witness. Wouldn't you tend to have compensation remain the same? You would just simply move part of what is paid in cash into the retirement plan, and the employees would receive nothing more than they are today.

Ms. **Andrews**. You've mentioned a very interesting issue, because most economists think that there are wage-pension tradeoffs, that the more compensation you give in terms of benefits, the less you're going to give in wages.

Empirical evidence has been very scarce, so we're dealing in a theoretical area. There are other types of economic impacts that could result if you raised the price of compensation.

If you're looking at minimum wage workers, you can't have any tradeoffs. You could have secondary effects of firms shutting down their pension plans because they couldn't take the costs or of firms not starting up pension plans. So it's very hard to determine where the incidence of these costs is going to be.

I might also add something that Mr. Myers certainly knows, that lower-income workers tend to have much higher replacement rates from Social Security. I think, as Mr. Erlenborn said, that the consideration of what type of replacement rate you want is very important to figure out the kind of policies in which you're interested.

Mr. **Chandler**. Thank you, Mr. Chairman.

Mr. **Clay**. Mr. Hayes.

Mr. **Hayes**. I'm just wondering, Mr. Myers, Dr. Andrews, what is your reaction to increasing the retirement age from its current level, permitting people to work longer? Would you favor that kind of legislation as it relates to Social Security particularly?

Mr. **Myers**. Mr. Hayes, I would strongly favor removing all restrictions for making people retire before any age. In other words, I would be in favor of eliminating the mandatory retirement age, as has been discussed widely.

I think that Chairman Pepper has often advocated this, and the administration also did, but it has not moved legislatively. I certainly think that the mandatory retirement age of 70 should be eliminated.

Now, as to increasing the so-called normal retirement age for Social Security, which, as you know, was enacted by the Congress in 1983, I strongly favored that because of the fact that it seems almost certain that in the future people will live longer. It seems extremely likely that they will be healthier and be able to work longer. Therefore, there should not be disincentives for them so that they will be compelled to retire earlier.

I believe that private pension plans should be able to move up their normal retirement age in step with what Social Security does. Then, people with private pensions, who are generally better off economically, will not be favored as against people who have only Social Security and must wait longer to get full benefits.

Mr. HAYES. Dr. Andrews.

Ms. ANDREWS. I think the retirement age issue is very interesting. As you know, the retirement age has been edged up under the 1983 Social Security Amendments, and at this time I believe that the Social Security Administration is mandated to conduct a study of the effects of this increase on workers.

I don't think that there has been legislation suggesting any conditions for raising the retirement age under private plans. At the current moment, the retirement age of private plans fits in with the employment situation of the firm and of the employees, and presumably fits to that situation.

One can imagine that there could be effects on private firms once the Social Security retirement age is increased, and I don't think we've even begun to study what those effects are likely to be. I also think that, fortunately, there is some time for us to break into this area, because the major effects are going to be a few years from now, when the baby boom reaches retirement.

Mr. HAYES. Just a comment, or maybe a question. I know my time is about to run out. If my memory serves me correctly, there were some people here last year, weren't there, Mr. Chairman, in that so-called forgotten era?

Mr. CLAY. The losers—pension losers?

Mr. HAYES. The pension losers who came along before ERISA, you know, and some who worked for firms who'd closed down—filed bankruptcy and all this—and they were asking for congressional help to do something about trying to provide some means of income or pension for them.

I noticed on your proposal you don't mention anything of that sort, but there are still people now who are being affected by firms who filed bankruptcy in the private system, and some other new companies won't purchase those through the bankruptcy courts because they don't want to assume the pension liability.

So we find people being hurt by this, but I'm more concerned about that forgotten group.

Do you feel that we ought to find a way to enact legislation to help those people who are still living? I get a feeling sometime, we're just waiting for them to die, and get out of the way, and we don't have that responsibility, but I still think that these people ought to have something done for them by the Federal Government because they came along, in effect, prior to ERISA.

I'd just like to know your reaction to that.

Ms. **Andrews**. I know that they're a small group of people and that some policy proposals have been made. I'm not about to propose a new policy, but I'm waiting eagerly to see what the Congress is going to do.

Mr. **Chandler**. Mr. Myers.

Mr. **Myers**. I see that problem, Mr. Hayes, but the difficulty is that, if you provide pensions for people who had lost them, what about people who never had pensions? Why should not they deserve something from the Federal Government?

Mr. **Hayes**. They do. I'll answer that.

Mr. **Clay**. Mr. Fawell.

Mr. **Fawell**. Just one question, Mr. Myers.

You indicated in regard to Medicare the possibility of greater cost to senior citizens and also the possibility of either lessening the quality of medical care or raising more taxes.

What about the concept of preventive health which seems to me to have great potential? I notice you didn't refer to that as being a potential that can indeed cut down the need for health care.

Mr. **Myers**. Mr. Fawell, I think that has some potential. It is really a part of one topic I mentioned—greater efficiency in the health care delivery system and greater efficiency on the part of the individual. But, in our free-wheeling democratic society, I cannot see this as being really a great element.

People should practice it, but you cannot compel them to take better care of themselves. I think that the preventive care advocates overemphasize how much can really be achieved this way unless you had a strictly regimented society where everybody got up at a certain time, ate certain things by governmental edict, and did not eat other things, did not smoke, et cetera.

So, it is something that certainly should be practiced by people for their own advantage, but I cannot see that as a major element in this cost picture.

Mr. **Fawell**. I just wondered why. It seems to me it is always somewhat discarded as though it's too much pie in the sky, and we thus don't really have education programs that are even emphasized.

Yet I've read somewhat extensively on really quite successful programs in regard to senior citizens who simply no longer were eating anything at all of any nutritional value. I guess as the older we get, the less our body is able to assimilate those foods and obtain the nutritional values.

Quite often—it's just a personal observation—we see a negative—not a negative attitude, but it just isn't something that we're quite ready for. We're ready to have the best and most costly of methods to be able to cure once the disease is there but we know and do little about being able to educate the population in general about what can be done to avoid it.

Mr. **Myers**. Certainly, there should be much done in education that way, but I would not count the savings from it until I saw them appear. I have not really seen them appear to a great extent.

Mr. **Fawell**. Thank you.

Mr. **Clay**. Mr. Owens.

Mr. **Owens**. Ms. Andrews, I think you indicated that you don't have statistics for 1983 and 1984, so you can't judge whether the expansion of the economy has generated more people with pension plan coverage. Is that correct?

Ms. **Andrews**. I think that's basically correct.

Mr. **Owens**. Would you say that the trend in the expansion of the economy is such that it's not likely to generate a lot of coverage because most of the expansion has been in the area of entrepreneur—very small funds, much smaller than 100 employees in many cases, consisting of two classes of employees really, the professionals at the top and then the people at the bottom who are generally paid the minimum wage or slightly above?

That trend seems to be the way the economy is going, generally toward the entrepreneur-type small business. Would you say that that's going to mean less and less pension coverage?

Ms. **Andrews**. There are many things that we don't know; however, I do know that a lot of new businesses tend to be small. We have information that a lot of new businesses are the types of small businesses that you're talking about. We also know that there is going to be an increase in service sector employment.

We know very little about the kind of change we're going to be having between large and small firms, because after the recovery, many of the large firms that laid off workers during the recession will have rehired those workers. So it's actually very difficult to say what the mix is going to be between small and large firms.

We started doing simulations to see what would happen to pension coverage if coverage rates held constant and there were an increase in employment the way the Bureau of Labor Statistics [BLS] thinks that employment is going to increase. Just doing that very simple exercise gave us a slight shift up.

Very few people are willing to forecast exactly what's going to happen, and that's why we really need to wait for the new statistics to come out.

Mr. **Owens**. Thank you.

Mr. **Clay**. Mr. Bartlett.

Mr. **Bartlett**. No questions, Mr. Chairman.

Mr. **Clay**. Well, we certainly want to thank you for your testimony.

The next witnesses will consist of a panel—Mary Hatwood Futrell and William Welsh.

Good morning, and welcome to the subcommittee.

Without objection, your entire statements will be entered into the record, and you may proceed, Mrs. Futrell.

STATEMENTS OF MARY HATWOOD FUTRELL, PRESIDENT, NATIONAL EDUCATION ASSOCIATION, ACCOMPANIED BY LINDA TARR-WHELAN, DIRECTOR, DIVISION OF GOVERNMENT RELATIONS, AND WILLIAM WELSH, DIRECTOR OF LEGISLATION, AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES, ACCOMPANIED BY CHARLES M. LOVELESS, LEGISLATIVE REPRESENTATIVE

Ms. **Futrell**. Good morning, Chairman Clay and members of the committee.

I have with me today Linda Tarr-Whelan, who is the director for the Division of Government Relations at the NEA.

My name is Mary Hatwood Futrell. I am the president of the 1.7 million-member National Education Association, which represents teachers, education support personnel, and higher education faculty in every State in the Union.

We're grateful to you, Mr. Chairman, and to members of the subcommittee for the insight you have shown in holding these hearings now.

It seems to be in vogue these days to address our national policy questions such as retirement, health, or welfare benefits in an immediate piecemeal fashion often in the sole context of enhancing revenues or cutting spending.

We know, however, that programs aimed at providing security and dignity to our elderly must not and cannot be exploited as political footballs tossed about the game of budget balancing or deficit slashing. They must be valued for what they are, intrinsic to a strong and secure Nation.

The attempt to develop a comprehensive national retirement income policy must go hand in hand, NEA believes, with the creation of a national employment policy.

Clearly, without the opportunity to have good paying and stable jobs during their productive years, our elderly would be forced into a bleak retirement, despite the good intentions of any social policy.

Any national retirement income policy must address the financial and health care needs of the elderly and help ensure the solvency of pension, retirement, and health systems into the future for all, including those workers who currently support these programs.

That's why NEA believes that a fundamental base for any retirement income policy must include a sound Social Security system, Medicare, public employee retirement protection, and appropriate employee benefits.

We would stress health care needs in particular. We know that—on average—fully 75 percent of lifetime medical expenses are spent in the last year of life. For those without sufficient health care coverage, this means ending their lives in destitution or living in a constant state of fear.

But developing a comprehensive income policy means more than that. It means addressing the need for adequate nutrition programs, expanded housing assistance, and the extension of other social and health services to assure our senior citizens that their experience and wisdom remain precious assets in our society.

Moreover, to reinforce the quality, availability, and long-term solvency of retirement income and pension plans is to address the future security needs of young workers. A fundamental guideline for these deliberations then is to keep first and foremost in mind that pensions and retirement plans are earned benefits; they are not a gift; they are a right.

We ask for your special attention to the needs of public employees who, unlike employees in the private sector, have virtually no Federal protection for their pensions.

We believe that passage of the Public Employee Pension Plan Reporting and Accountability Act would do a great deal to address our most substantial concerns about public employee retirement and pension systems.

We also believe that the safeguards and standards called for in PEPPRA should be included in any guidelines developed as a foundation for a national retirement income policy.

We cite, in particular, the need for disclosure and accountability in public employee pension and retirement plans, portability of coverage for public education employees, and exemption from Federal guidelines for States with statutes substantially equivalent to Federal standards.

Finally, we urge you to reject the current rash of proposals to tax employee benefits such as health and life insurance, education and legal assistance, and pension and retirement contributions. These benefits have substantially increased the quality of life for millions of Americans, and we believe the proposals to tax them are unsound economically and represent bad public policy.

Tax law which provides significant benefits to society must be preserved without taxing these benefits for individuals.

Mr. Chairman and members of the subcommittee, NEA wishes to continue as a partner with Congress in these deliberations over the creation of a national retirement income policy.

As NEA invests its resources to assure each and every child in America the opportunity for equality of access to education, so shall NEA continue to press for the right to a life of quality and dignity for all of our elderly. To do less would be to fall short of our moral and professional responsibilities.

Thank you for the opportunity to testify this morning.

[Prepared statement of Mary Hatwood Futrell follows:]

PREPARED STATEMENT OF MARY HATWOOD FUTRELL, PRESIDENT, NATIONAL EDUCATION ASSOCIATION

Mr. Chairman and Members of the Subcommittee: My name is Mary Hatwood Futrell. I am President of the 1.7 million member National Education Association (NEA) which represents teachers, education support personnel, and higher education faculty in every state in the Union. I am pleased to have this opportunity to appear before you this morning to speak about the development of a national retirement income policy—an issue that is vitally important to our members, and indeed, to the entire nation.

We are grateful to you, Mr. Chairman and to Members of the Subcommittee, for the wise perspective you have shown in holding these hearings now. It seems to be in vogue to deal with national policy questions such as retirement, health, or welfare benefits in an immediate, piecemeal fashion, often in the sole context of enhancing revenues or cutting spending. Yet, as we encourage Americans to begin planning for their retirement years long before they receive their last paycheck, so too must the national plan, for a retirement income policy be considered within the context of longterm national needs and goals. Programs aimed at providing security and dignity to our elderly must not and cannot be exploited as political footballs to be tossed about in the game of budget-balancing or deficit-slashing, but should be viewed as intrinsically vital to a strong and secure nation.

The endeavor to develop a truly comprehensive retirement income policy must, of course, be undertaken as a partnership of state, local, and national governments, as well as of employees and employers. That is why this hearing today and your ongoing work to review the larger policy questions involved in defining and then developing a policy to support a quality life for all our elderly is a truly judicious use of Congressional leadership. For this we commend you and are pleased to be working with you.

RETIREMENT POLICY NEEDS COMPREHENSIVE EMPLOYMENT POLICY AS BASE

NEA believes that the attempt to develop a comprehensive retirement income policy must go hand in hand, with creation of and support for a national employment policy. Clearly, without the ability to have good-paying and stable jobs during their productive years, our elderly would be forced into a bleak retirement despite the good intentions of any social policy. NEA reiterates its longstanding support for the goals outlined in the Humphrey-Hawkins Full Employment Act. True implementation of this eminently sensible and realistic Act would help ensure that the fate of those millions who now become victims of business cycles or suffer the effects of longterm unemployment would be considerably more secure. A full-employment economy in the U.S. would provide the stable foundation on which a meaningful and lasting retirement income policy could be constructed.

RETIREMENT INCOME—A QUALITY OF LIFE ISSUE

The NEA is dedicated to the goal of a decent standard of living for all retirees and asks that this Subcommittee take into account the multitude of factors affecting the quality of life for our growing body of senior citizens. A significant public service will be accomplished if this inquiry shows clearly and in a broad perspective the inequities that exist as a result of, or due to the absence of, federal law and policy, and if the picture of retirement life that emerges points the way to legislation that would ease the financial burdens that afflict the aging.

In addition to a sound Social Security system, Medicare, public employee retirement plan protection, and employer-paid benefits, we are concerned about adequate nutrition programs, expanded housing assistance, and extension of other social and health services to help assure our senior citizens that their experience and wisdom are precious assets in a society that appreciates their lifelong contributions to its progress and welfare.

Mr. Chairman, retirement income is not a gift, nor is it welfare. It is an earned benefit. And it must be protected as such. We must safeguard the well-being of our older citizens from inflation and the decreasing purchasing power of their retirement income. We must aid them in their quest for dignity and decency in their later years. We must assure that employees have adequate control of their own pension programs. And we must meet the concerns of countless young Americans who worry about whether their retirement program will even be there when they retire.

SOCIAL SECURITY SOLVENCY AND FAIRNESS A MUST

NEA worked intensively with the Congress in 1983 to help pass legislation to restore the solvency of the Social Security trust funds. So successful was this effort that current studies show there will be substantial surpluses in the Old Age and Disability Insurance trust funds through the year 2030, barring any unforeseen economic catastrophe. At the present time, the Social Security system is actually helping to reduce the federal deficit by running comfortably in the black, meaning that it makes no sense to freeze the annual cost-of-living adjustment for Social Security beneficiaries. Congress has already voted to remove the Social Security system from the unified budget to protect it against the political whipsaws that give rise to proposals like freezing the COLA. We urge the Members of this Subcommittee to help avoid a COLA freeze when the budget is considered in the House of Representatives.

NEA members continue to resent the government pension offset, a provision in Social Security law that unjustly penalizes education personnel who are public employees. This offset reduces the amount of spousal benefits that a retired public employee can receive if that employee is eligible for a public pension from a job that was not covered by Social Security. The government pension offset unfairly weighs upon the public education employees of this country and we urge this committee and Congress to assist in the resolution of this issue in a fair and humanitarian way.

Mr. Chairman, marriage is clearly an economic partnership. Each spouse contributes services of economic value to the family—whether by working in the labor force or by caring for children and working without pay in the home. Yet unpaid work in the home is not counted as work to qualify for Social Security benefits, and counts, in fact, as zero in averaging the woman's lifetime wage record.

Earnings sharing would base Social Security benefits on earnings records shared equally by a couple for each year of their marriage. It would acknowledge each person as a worker with an earnings record for all work done—whether in the home or in the paid labor force.

In terms of coverage, no retirement income policy should mandate programs without the involvement and consent of those covered. Therefore, it is our view that Social Security should be available to eligible school employees where desired, but should not be mandated. Social Security contracts with the Department of Health and Human Services should provide for supplementary plans rather than integrated or coordinated ones.

MEDICARE—A LIFELINE FOR THE ELDERLY

Mr. Chairman, far too many Americans still live in constant fear of the catastrophic effect illness might have on their retirement income. It is estimated that on average 75 percent of an individual's lifetime medical expenses occur in his or her last year of life. As a result, Medicare has served as a vital lifeline for the elderly. Yet, we have seen this program in recent years come under assault. The Reagan Administration's FY '86 budget proposal, for instance, calls for a freeze on hospital Diagnostic-Related-Groups (DRG) rates, along with payments to nursing homes and home health agencies. It would extend for another year the current freeze on payments to physicians. Proposed cuts to providers would total $3.3 billion in FY '86, and amount to 63 percent of all the Medicare cuts. While it may appear that the Administration is getting tough by proposing to freeze Medicare payments to hospitals and doctors, the reality is that most of these reductions will be made up by the elderly and disabled.

Physicians who have never accepted Medicare fee levels will expect their patients to pay for lost reimbursements. Hospitals will look to other insurance payors to make up any shortfall in their payments. As a result, the elderly will be forced to pay more for insurance policies which supplement employment-based private insurance. Moreover, the proposed freeze would give hospitals, some of which in the past have refused to treat Medicare patients, additional incentives to turn away beneficiaries. Other facilities will try to reduce the cost of treating the disabled and those over 65 by compromising on the quality of care.

In addition to bearing the burden of any potential freeze in payments to providers, under the Administration's budget plan, Medicare beneficiaries would be required to pay more per month for physician services. Their share of such costs, which is deducted from monthly Social Security checks, would gradually increase so that by 1990 their monthly contribution in today's dollars rise by 42 percent.

PUBLIC EMPLOYEES: THE NECESSITY OF PROTECTION AND PARITY WITH PRIVATE SECTOR COLLEAGUES

Mr. Chairman, as you are well aware our members are public employees. And I would like to spend a few moments discussing the particular needs of those in the public sector.

Public employees now comprise a substantial percentage of the labor force in the U.S. Public school employees are roughly 45 percent of that public sector total. And public school employees' pension and retirement assets amount to nearly $190 billion and are expected to double in the next six years. NEA believes that the creation and implementation of a national retirement income policy must take into account the needs of public sector employees.

Public education employees want what every other American worker wants: a sound, predictable, and enjoyable retirement. Today, there may be as many as 6,600 state and local government pension plans representing a major source of future retirement income for more than 11 million public employees and their dependents.

Yet, unlike employees in the private sector, these public sector individuals have virtually no federal protection for their pensions. Perhaps this would be of little concern if state law always provided the kind of protection these men and women need and deserve. Sadly, a wide range of studies has demonstrated the continuing inability of many states to set adequate standards and to cause their pension plans to live up to them.

Clearly, the Federal Government has an interest in and a responsibility for the protection of public employee pension funds. Many states and municipalities rely heavily on federal funds to help meet pension costs. The growth and maintenance of such plans has had and continues to have an ever-increasing effect on federal revenues. This growth, moreover, has been substantially facilitated by the favorable tax treatment of participants and beneficiaries, investment earnings and contributions. As a result, we believe that the Federal Government can and should play a role in assuring that public pension plans are operated openly and honestly. We believe that this federal role can and must, furthermore, be accomplished without an intrusion on the automony of state and local governments.

Public employees, like all Americans, have every right to expect that their retirement systems be secure and adequately funded, that their public pension plans be operated openly and honestly, that benefits promised will be benefits paid. They want and deserve reasonable ownership rights to their plans and the opportunity for options that would make their pension plans portable. They are entitled to certain basic information about their plan's condition and activities and about their own benefits and rights—and they should have that information presented to them in a manner that is clear, understandable, and uniform.

We believe the provisions of the Public Employee Pension Plan Reporting and Accountability Act as introduced in the 98th Congress would do a great deal to address our most substantial concerns about public employee retirement and pension systems. We also believe that the safeguards and standards called for in PEPPRA should be included in any guidelines developed as a foundation for a national retirement income policy. For these reasons, we want to review some of the key provisions in PEPPRA that we feel must be included in an income policy. These provisions address the need for:

Standardized terms, reporting periods, and some guarantee that the benefits reported are comparable from state to state;

Plan participants to have adequate access to pertinent information about their plan, its operations, and benefits in simple and plan language;

A safeguard for the health and solvency of public employee plans through minimum fiduciary standards;

State and local retirement systems and programs to include actuarial and investment policies that produce sound financing, annual independent review and audit, protection against incursions on retirement system assets by state and municipal governments, and fiduciary standards mandating prudent operation of public employee pension plans;

Minimum standards including vesting at no longer than five years, and the portability of coverage;

Minimal work restrictions that would impinge on retired teachers' work as substitutes;

Exemption of states with statutes substantially equivalent to the federal standards.

NEA believes that passage of legislation such as the Public Employee Pension Plan Reporting and Accountability Act would enable us to move another step closer to developing a rational and effective retirement incomes policy, and would help insure the economic security of our older citizens.

Public employees—like all Americans—are deeply concerned about the effects of inflation and the decreasing purchasing power of their retirement income. This is augmented by the absence of a meaningful cost-of-living adjustment policy for public pension benefits. Any national retirement income policy must address itself to this concern.

PENSION PORTABILITY A MUST

NEA continues to press for portability of coverage for public education employees. Although teacher mobility has decreased in recent years, statistics show that nearly one-fifth of the nation's teachers have lost retirement credits by accepting teaching positions in other states. This represents a significant problem, especially for older teachers.

In 1981, an estimated 225,000 teachers withdrew their contributions from their pension funds because they had left employment in their state. They could not withdraw their portion of the earnings on investment and the corresponding employer contribution. Indeed, in the 45 states from which we have recent data, the retirement system benefited by over $700 million in unrefunded employer contributions.

The problems of portability due to crossing state lines has been a longterm concern of the NEA. In 1946, after the last state established a teacher retirement system, the NEA and the National Council on Teacher Retirement turned their attention to developing a system of reciprocity of pension credits between states. This effort has resulted in the enactment in many states of provisions which permit deferred retirement allowances and the purchase of out-of-state credit, but barriers to reciprocity of pension credits remain. Hence, the NEA would call upon Members of this Subcommittee to consider pension portability an essential element of any national retirement income policy. Moreover, we stress that pension portability must not come at the expense of benefits.

TAXING EMPLOYEE BENEFITS—SHEER FOLLY

NEA members view with alarm the current rash of proposal to tax employee benefits such as health and life insurance, education and legal assistance, and pension and retirement contributions. Such taxation would fundamentally alter our nation's retirement income and security programs. Moreover, given the generally low level of salaries in public education, the taxation of such benefits would be a further disincentive for education personnel to remain in the profession. Pension coverage and health benefits are two of the benefits that to some degree balance the small paycheck. For many teachers and support personnel, the taxation of these benefits would be the last straw forcing them to leave education.

A significant longterm effect of taxing these benefits would be the need to enact additional money measures to compensate for the relative dollar loss of employer-paid benefits. NEA believes the nation cannot now or in the future afford the loss of those benefits.

We believe that the tax laws favoring employee benefits were enacted and should be continued on the premise that such benefits are good social policy. The encouragement of health insurance protection or improved education of workers strengthens our citizens. The encouragement of employers and employees in this area is good public policy. For example, the tax law has succeeded in distributing pension coverage broadly among lower- and middle-income workers, affording families a type of savings plan that could be difficult to maintain on individual initiative. It has helped spread health insurance coverage across the income spectrum. Educational assistance has helped the unemployed, underemployed, and the lower wage earners help themselves. Group life and accident insurance provide enormously valuable protection to families, and such programs are, for most workers, an irreplaceable supplement to their private insurance and Social Security coverage. Tax law which provides these significant benefits to society must be preserved without taxation of employee benefits for individuals.

CONCLUSION

Mr. Chairman and Members of the Subcommittee, NEA wishes to continue as a partner with the Congress in these deliberations over the creation of a national retirement income policy. As NEA invests its resources to ensure each and every child in America the opportunity for equality of access to an education, so shall NEA continue to press for the right to a life of quality and dignity all of our elderly. To do less would be to fall short of our moral and professional responsibilities.

I thank you for this opportunity to present our views today.

Mr. CLAY. Thank you.

Mr. Welsh.

Mr. WELSH. Mr. Chairman, I'm Bill Welsh. I'm the legislative director of the American Federation of State, County, and Municipal Employees, and I'm pleased to join with the NEA this morning in focusing on the impact of national income retirement policy as it would affect State and local employees.

As the subcommittee considers these issues, we urge you not to neglect the concerns of the more than 13 million active and retired State and local government workers who depend on basic workplace benefits to protect them and their families in the event of retirement, sickness, or death.

State and local government employees forgo billions of dollars in wages and other forms of compensation in order to participate in these various programs, but they frequently do not enjoy the same rights and protections as their counterparts in the private sector.

In our view, two major components of a Federal employee benefit retirement income policy should be the continuation of certain special tax provisions which have served to encourage both employers and employees to participate in workplace benefit programs and also the enactment of certain minimum Federal standards for State and local government pension plans.

AFSCME has worked to provide adequate benefit packages for our members. These various benefit programs provide vital protection to public employees and their dependents. We have proudly pioneered in providing coverage for cost-effective preventive care, outpatient diagnostic services, dental coverages, eyeglasses, prepaid group legal assistance, and other important services which have significantly contributed to workers' well-being and security.

However, in our view, these various workplace benefit programs, including workmen's compensation and unemployment compensation, will be seriously jeopardized if Congress eliminates the tax-favored status of employee benefits.

Moreover, the possibility of negotiating fringe benefit improvements in the future for workers who currently lack adequate coverage will be substantially reduced.

Responding to the efforts of the Reagan administration and various Members of Congress to tax employee benefits, AFSCME retained the prominent employee benefit consulting firm of Mercer-Meidinger to make an independent determination of the extent to which certain changes in employee benefit tax rules would result in Federal tax increases for public employees. Mercer-Meidinger developed a computer calculation model to determine the effect of certain benefit taxation programs on employees in various State and local jurisdictions.

The model is designed to measure changes in the amount of taxes, both income and Social Security taxes, that a single employee and a married employee with two dependents, at two salary levels—$15,000 and $30,000 annually—would be expected to pay if certain taxation proposals were enacted. While this final report won't be available to the committee and to us until mid-April, we're releasing today the preliminary results of the study.

We looked at the State of Michigan, we looked at Cook County, IL, and at the University of California. I want to show you the charts—the charts are attached to the testimony. They graphically show what, in fact, will happen if the Treasury Department's plan for taxing employee benefits is put into effect.

For example, if you're working at the University of California today, and you're earning $15,000 as a clerical employee in one of the offices, and you're single, under the Treasury's proposal, you will be increasing that employee's Federal income taxes by about $225 a year. If you are married, and your spouse is not employed, and you are earning $15,000, you will be increasing the Federal tax on your benefit package at the University of California by almost $600 a year. If both spouses are earning $15,000—in effect, the combined income was $30,000—you'd be increasing the combined family's Federal tax by almost $1,000 a year.

Mr. **Clay**. We want to interrupt for a question.

Mr. **Welsh**. Yes, sir.

Mr. **Chandler**. Mr. Welsh, I apologize. I just want to ask a clarifying question.

Mr. **Welsh**. Sure.

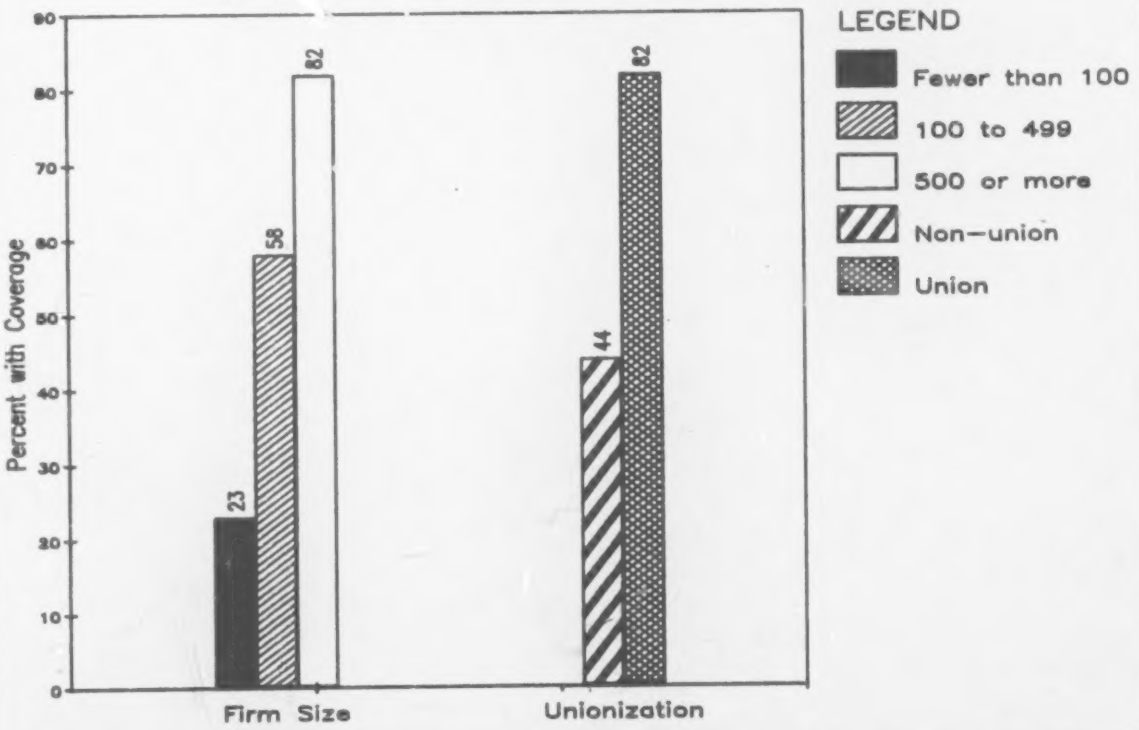
Mr. **Chandler**. Does this assume a lower rate?

Mr. **Welsh**. No, it does not assume a lower rate.

Now, let me explain why we present it this way, because I think it's important.

Chart 3

Percent of Non-Farm Private Employees with Pension Coverage, by Firm Size and Unionization, May 1983



One, we don't know what that lower rate is going to be, and if it, in fact, brings the rate down by 2 percent or 3 percent, obviously, you would adjust our calculations accordingly.

But the important point we want to make to the committee is that we are very close to doing something through the tax laws that would, in fact, have a major impact on income retirement policy. This would be an extraordinary action, and while the Congress has talked about a tax-neutral change, it would not be tax neutral for a great many potential Federal taxpayers. You know and I know that once we start down this line, even though the first bite may be a very small one, once we begin to move and think about taxing benefits, it is extremely significant action. So we think this is a very dangerous step to take, even though the initial step may be very small.

Let me just very quickly show you what the impact would be on the State of Michigan in terms of the same assumptions—slightly lower in terms of each of the categories.

The charts in the back also show the results for Cook County. We will have a whole range of these analyses of specific contracts for you. I don't know why we picked out Cook County, but it seemed to us to be maybe appropriate.

Finally, Mr. Chairman, in terms of concluding my testimony, we want to strongly commend you and the other members of the committee—Mr. Chandler and others—for sponsoring the PEPPRA bill. We think that as we move into this area, not to have the facts as to what really is out there in the State and local pension area available to the Congress in setting policy is extraordinary.

We think all constitutional issues on this issue have now been resolved as a result of the Surpreme Court's *Garcia* decision, and we hope that your subcommittee and the Congress, will move rapidly to enact this important legislation.

[Prepared statement of William Welsh follows:]

PREPARED STATEMENT OF WILLIAM B. WELSH, DIRECTOR OF LEGISLATION, THE AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, AFL-CIO, WASHINGTON, D.C.

Chairman Clay and distinguished members of the Subcommittee, I am William B. Welsh, Director of Legislation of the American Federation of State, County and Municipal Employees (AFSCME). I am accompanied by Charles M. Loveless of AFSCME's Department of Legislation. We are appearing today on behalf of the more than one million members of AFSCME who work for state and local governments across the nation.

We would like to commend the Chairman and members of the Subcommittee for holding this series of hearings focusing on employee benefits and the need for a federal retirement income policy. Certainly, there is a pressing need to develop and implement a coordinated and comprehensive national retirement income and employee benefit policy. The 1981 final report of the President's Commission on Pension Policy (the Commission) found that serious deficiencies exist in such programs. Among the major problems which the Commission identified and which we believe merit attention include:

- Lack of coverage for many Americans;
- Low benefits for many who are covered;
- Gaps in protection for women;
- Erosion of retirement benefits due to inflation; and
- Employment problems of older workers.

As the Subcommittee considers the many important issues relating to the development of such a policy, we urge you not to neglect the concerns of the more than thirteen million active and retired state and local government workers who depend on basic workplace benefits to protect them and their families in the event of retirement, sickness and death. State and local government employees forgo billions of dollars in wages and other forms of compensation in order to participate in these various programs. But, they frequently do not enjoy the same rights and protections as their counterparts in the private sector.

In our view, two major components of a federal employee benefits and retirement income policy should be the continuation of certain special tax provisions which have served to encourage both employers and employees to participate in workplace benefit programs and the enactment of certain minimum federal standards for state and local government pension plans. We have set forth below in some detail our reasons for advocating such policies.

I. Congress Should Continue to Provide Preferential Tax Treatment for Employee Benefit Programs.

The tax simplification proposal recently released by the Treasury Department and similiar proposals which have been introduced in the Congress would tax health care and other vital workplace benefits provided to workers by their employers. The tax exemption of many employee benefits would be cut back or eliminated as part of a larger effort to restructure the tax system, raise federal revenues and help reduce the federal budget deficit. For example, the Treasury Department plan would:

1. Tax employees on employers' health care contributions that exceed $70 a month for individual coverage and $175 for family coverage.

2. Tax employees on employer contributions for group term life insurance, group legal assistance, education assistance and dependent child care.

AFSCME has worked to provide adequate benefit packages for our members. These various benefit programs provide vital protection to public employees and their dependents. We have proudly pioneered in providing coverage for cost-effective preventive care, outpatient diagnostic services, dental coverage, eyeglasses, prepaid group legal assistance and other important services which have significantly contributed to workers well-being and security. However, in our view, these various workplace benefit programs will be seriously jeopardized if Congress eliminates the tax-favored status of employee benefits. Moreover, the possibility of negotiating fringe benefit improvements in the future for workers who currently lack adequate coverage will be substantially reduced.

Responding to the efforts of the Reagan Administration and various members of Congress to tax employee benefits, AFSCME retained the prominent employee benefit consulting firm of William M. Mercer-Meidinger, Incorporated to make an independent determination of the extent to which certain changes in employee benefit tax rules would result in federal tax increases for public employees. Mercer-Meidinger developed a computer calculation model to determine the effect of certain benefit taxation proposals on employees of various state and local jurisdictions. The model is designed to measure changes in the amount of taxes (both income and Social Security taxes) that a single employee and a married employee with two dependents and at two salary levels ($15,000 and $30,000 annually) would be expected to pay if certain taxation proposals were enacted.

While the final report of the study will not be available before mid-April, Mercer-Meidinger has, to date, examined the impact of various benefit taxation proposals, including the Treasury Department's plan, on employees working for three public employers, the State of Michigan, Cook County, Illinois and the University of California. We are today releasing to the Subcommittee the interim report of Mercer-Meidinger which presents the specific findings. It is set forth below as Attachment A.

Several preliminary conclusions can clearly be drawn from the study thus far:

- Employees in all of the three tested jurisdictions would pay considerably higher taxes under the current tax structure if any of the proposals were enacted.
- Working couples would pay significantly higher federal income and Social Security taxes if all employer life insurance and medical plan contributions above a tax-exempt cap were taxed.

  While a more detailed picture of how public employees would likely be affected by these tax changes will be available when the final report is released, the interim report clearly disputes the notion that workplace benefits can be targeted for taxation without harming the average worker. Clearly, taxing employee benefits will increase the tax liability of many public employees and other low and middle income workers. It will amount to a pay cut to many workers who are already paying more than their fair share of federal taxes.

Taxing employee benefits is also bad health policy. In trying to avoid taxation, rational consumers will not reduce expensive hospital coverage, but instead will eliminate cost-effective preventive services. Moreover, it may encourage younger, healthier workers to seek to drop out of various benefit programs, thus increasing cost for older and less healthy workers in the form of higher premiums and out-of-pocket expenses.

The employee benefit program under attack are not frivolous corporate perks or tax avoidance schemes. Instead, they provide extremely important protections for American workers and their families. Congress should continue to provide, through the tax laws, incentives for the development and maintenance of such programs. As AFL-CIO President Lane Kirkland stated, in recent testimony on this issue before the full Committee, "(i)t is unfair that all workers do not benefit by an adequate medical program,

> pension protection, life insurance and other benefits. But such inequities should be resolved through public and private policies that encourage a leveling-up of benefits, not by policies that seek to reduce everyone to the lowest common denominator."

II. Minimum Federal Reporting and Disclosure and Fiduciary Standards Should be Enacted to Protect the Interests of State and Local Government Pension Plan Participants and Beneficiaries.

Unlike their counterparts in the private sector who are protected by ERISA, state and local government workers have virtually no federal retirement income protections. It does not seem an unusual notion that the assets of any pension plan "belong" to its participants, that they should be invested for the "exclusive benefit" of the plan participants and beneficiaries and that the individuals who control those assets should be held under the law to a high standard of behavior. In fact, all this is the care in the private sector. Unfortunately, it is by no means a settled proposition in the state and local government sector. Conflicting and ambiguous state and local laws, if any exist, and court decisions have created much uncertainty about the legal rights of participants in state and local government pension plans.

Currently, the pension funds for state and local government employee hold over $260 billion in assets. They are predicted to grow at a rate of nearly $30 billion per year for the next five years. These pension funds are an important source of capital for the states in which they are located and the nation as a whole. Yet the management of these funds is often characterized by conflict of interest, restrictive state laws, political manipulation and unprofessional portfolio management. Attempts at reform are too often thwarted by local business or political interests.

State and local government pension plans face problems which threaten not only their own fiscal stability and the rights of plan participants and beneficiaries, but also the fiscal integrity of state and local governments as well. The benefit design of many of these plans is ill-conceived, and many are dangerously underfunded. No comprehensive and uniform set of legal principles exist to adequately regulate state and local government plans. The absence of meaningful reporting and disclosure of basic plan information to plan participants, public officials and the taxpayer is the order of the day. A coherent federal regulatory framework which recognizes the unique problems and characteristics of state and local plans has yet to be established.

The scope of the crisis confronting state and local government pension plans is graphically documented in a recently released report on state and local plans. The study, Dollars and Sense: The Case for State and Local Pension Reform, set forth below as Attachment B, was commissioned by AFSCME and prepared by

Thomas Woodruff, Executive Director of the President's Commission on Pension Policy. We strongly concur with the central conclusion of the Woodruff study, of the 1978 Pension Task Force Report on Public Employee Retirement Systems issued by the Committee and of a host of other public and private studies that current regulation of state and local plans is inadequate and that federal legislation must be enacted to protect the vital national interests involved.

As a constructive means of addressing the public pension crisis, AFSCME strongly supports the enactement of uniform standards of fiduciary conduct and of reporting and disclosure for state and local government retirement systems. Now, ten years after the enactment of ERISA, it is time for Congress to adopt legislation along the lines of the Public Employee Pension Plan Reporting and Accountability Act (PEPPRA) which was reported out of the Committee with overwhelming bipartisan support.

By focusing exclusively on minimum reporting and disclosure and fiduciary standards, such legislation will minimize the degree of federal intrusion in state and local government affairs. Effective reporting and disclosure and fiduciary standards will ensure that state and local pension problems are solved at home, rather than in Washington, D.C. Certainly, the Supreme Court's recent decision in Garcia v. San Antonio Metropolitan Transit Authority removes any semblance of doubt concerning the constitutionality of such legisaltion.

We thank the members of the Subcommittee for the opportunity to present our views on these issues of fundamental concern to state and local government workers. We would be pleased to answer any questions you may have.

Attachments (2)

A-Mercer-Meidinger, Inc., Interim Report with Graphs
B-Thomas Woodruff, Dollars and Sense: The Case for State and Local Pension Reform

ATTACHMENT "A"

WILLIAM M
MERCER-Meidinger

INTERIM REPORT
ON THE
EFFECT OF PROPOSED CHANGES IN THE TAX TREATMENT OF EMPLOYEE BENEFITS ON PUBLIC EMPLOYEES

A Study Undertaken for the
American Federation of State, County and Municipal Employees
(AFSCME)

By
William M. Mercer-Meidinger, Incorporated
Washington, D.C.

March 19, 1985

Introduction

This report briefly discusses the current environment for tax reform in the employee benefit area, describes Mercer-Meidinger's benefit tax study for AFSCME, and presents preliminary findings from that study.

Congress has enacted tax laws over the years that give preferential tax treatment for employer contributions to employee benefit plans. For example, employees do not pay income tax on employer pension plan contributions until benefits are distributed. Employer contributions to group life insurance plans are not taxable to employees except for contributions attributable to coverage above $50,000, and employer contributions to group medical plans are tax exempt altogether. In the private sector, employers may deduct their benefit plan contributions on their tax returns as a business expense, provided their plans meet Internal Revenue Code requirements.

Such preferential tax treatment has been an important incentive for private employers to establish employee benefit plans. The growth of these plans in state and local government generally has followed the development of private sector plans. Today, most full-time public and private sector employees are covered by employer-provided medical, life, and pension plans.

Preferential tax treatment of employee benefits is now under close review by the Administration and the Congress. This is part of a larger effort to restructure the entire federal tax system, raise federal revenues, and help shrink the ballooning federal deficit. Many authorities on employee benefit plans contend that if major changes in benefit tax rules are enacted, employees generally would be affected adversely, and those in the lower and moderate salary brackets would be affected most severely.

Responding to this surge of tax reform activity, AFSCME retained William M. Mercer-Meidinger, Incorporated to make an independent determination of the extent to which certain changes in employee benefit tax rules would result in federal tax increases for public employees.

Mercer-Meidinger Study

Mercer-Meidinger developed a computer calculation model to make this determination. The computer model is being tested on an array of state and local government employers. Hypothetical employees in the model are age 45 and have completed 15 years of service.

The computer calculation model measures changes in the amount of taxes (both income tax and Social Security tax) that a single employee and a married employee with two dependents would be expected to pay in 1985 under the current federal tax system. Each scenario presumes that employer contributions will be taxable for Social Security purposes as well as for income tax purposes. The results show the tax effect at salaries of $15,000 and $30,000.

The following scenarios are being tested:

Proposal #1:	Employees are taxed on the employer's cost for employer-provided pensions, life insurance, medical, dental, prescription drugs, and vision care benefits, legal assistance, and dependent care assistance.
Proposal #2:	Employees are taxed as in Proposal #1, except for employer pension plan costs, which are considered tax exempt.
Proposal #3:	Employees are taxed only on employer contributions for employer-provided life insurance coverage and for employer medical plan contributions above a tax-exempt cap of $70 per month if single and $175 per month if married.

After each scenario has been tested on a wide array of public employers, Mercer-Meidinger will analyze the results and present its findings in a comprehensive report that will be submitted to AFSCME in mid-April.

Preliminary Findings

To date, Mercer-Meidinger has developed its computer calculation model and has tested each of the three scenarios described above on hypothetical employees working for three public employers: State of Michigan, Cook County, Illinois, and the University of California. The accompanying tables and graphs present specific findings.

Several preliminary conclusions can be drawn from the data thus far:

- o Employees who were tested on these public employers would pay higher taxes in 1985 under the current federal tax structure if any of the above scenarios were enacted.
- o Two-earner couples would pay significantly higher federal income tax and Social Security tax if all employer life insurance contributions and employer medical plan contributions above a tax-exempt cap were taxed.
- o Employees who are covered by Social Security would pay higher Social Security tax, as well as higher federal income tax, under each of the three scenarios.

A detailed picture of how public employees would likely be affected by these tax changes will emerge as the computer calculation model tests the effect of each scenario on other public employers.

ATTACHMENT "B"

DOLLARS AND SENSE:

The Case for State and Local Pension Reform

By Thomas C. Woodruff

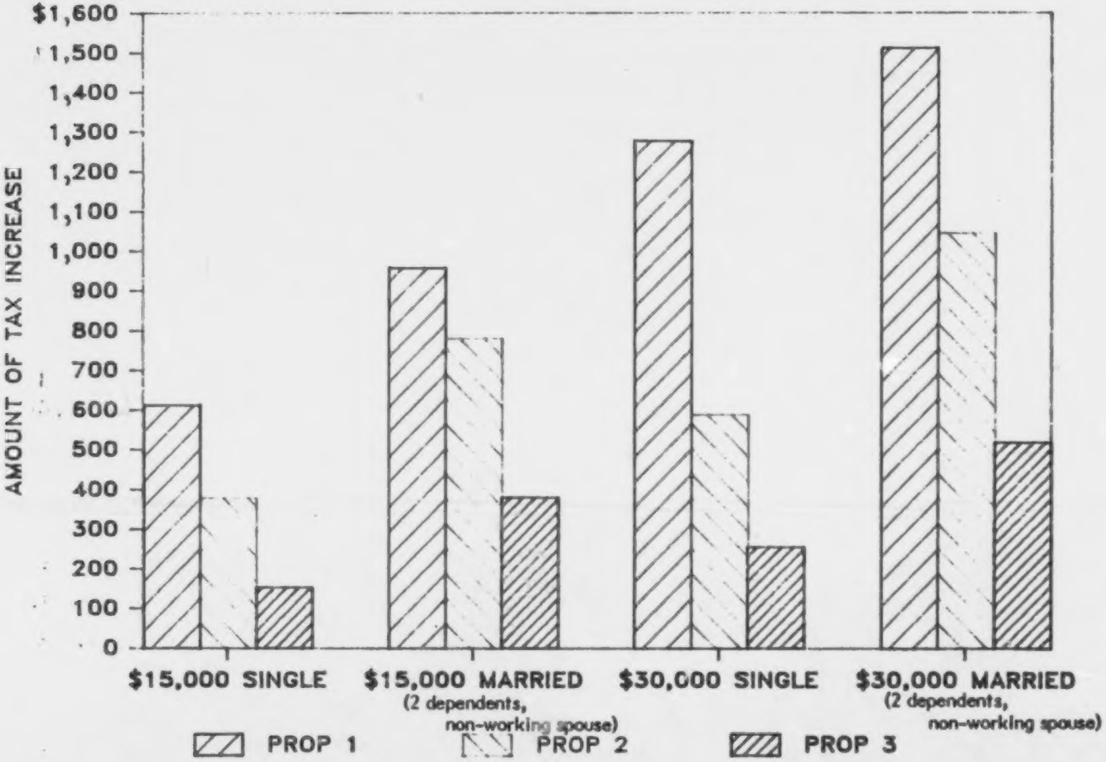
Preface

This independent report on state and local government retirement systems by Thomas Woodruff, former Executive Director of the President's Commission on Pension Policy, highlights a serious and troublesome national problem. This report, the report of the Pension Task Force of the House Education and Labor Committee and numerous other public and private studies all underscore one essential fact: our state and local public employee retirement systems are on the brink of a major crisis. The problems threaten more than the fiscal stability of these plans; they threaten as well the many people who depend on public retirement systems for their current or future economic security; and finally, they threaten the basic fiscal integrity of state and local governments.

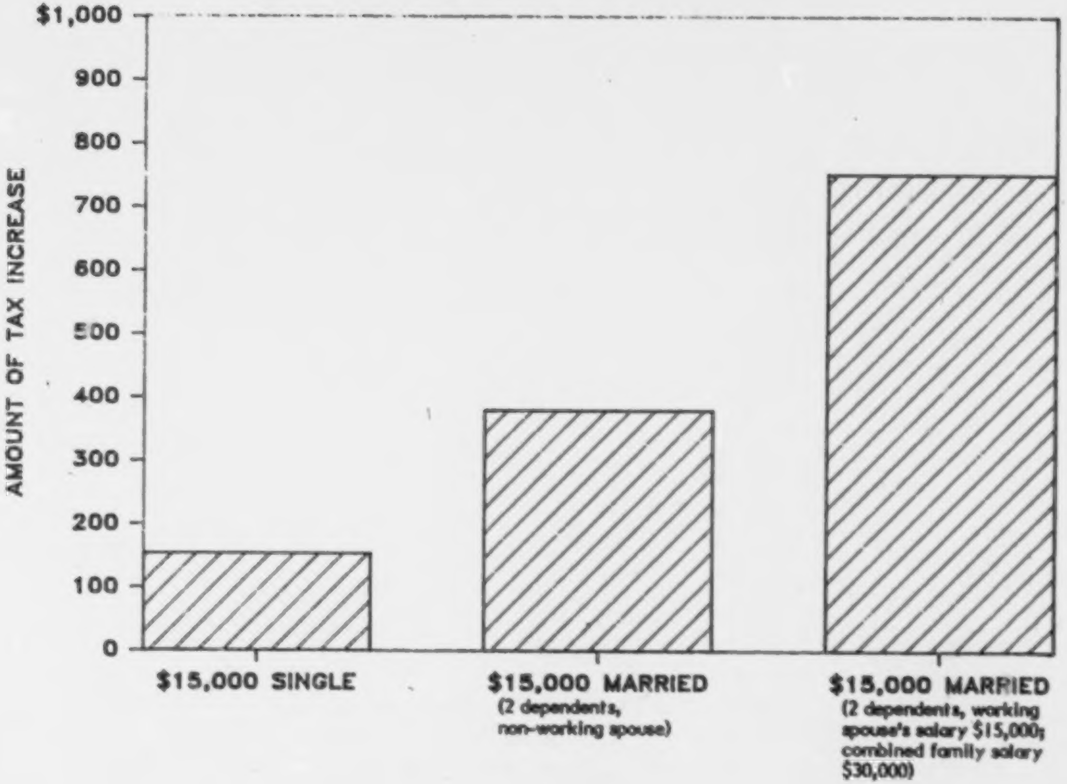
From our studies of these many reports, we believe that certain conclusions are inescapable:

- Many public pension systems are dangerously underfunded.
- There is no comprehensive and uniform set of legal principles that adequately safeguards the operation of state and local plans.
- Fiduciary protections are far less than they should be; meaningful standards for reporting and disclosure are notable by their absence.
- Until this time, the Federal Government has done little to protect the millions of participants who are affected.

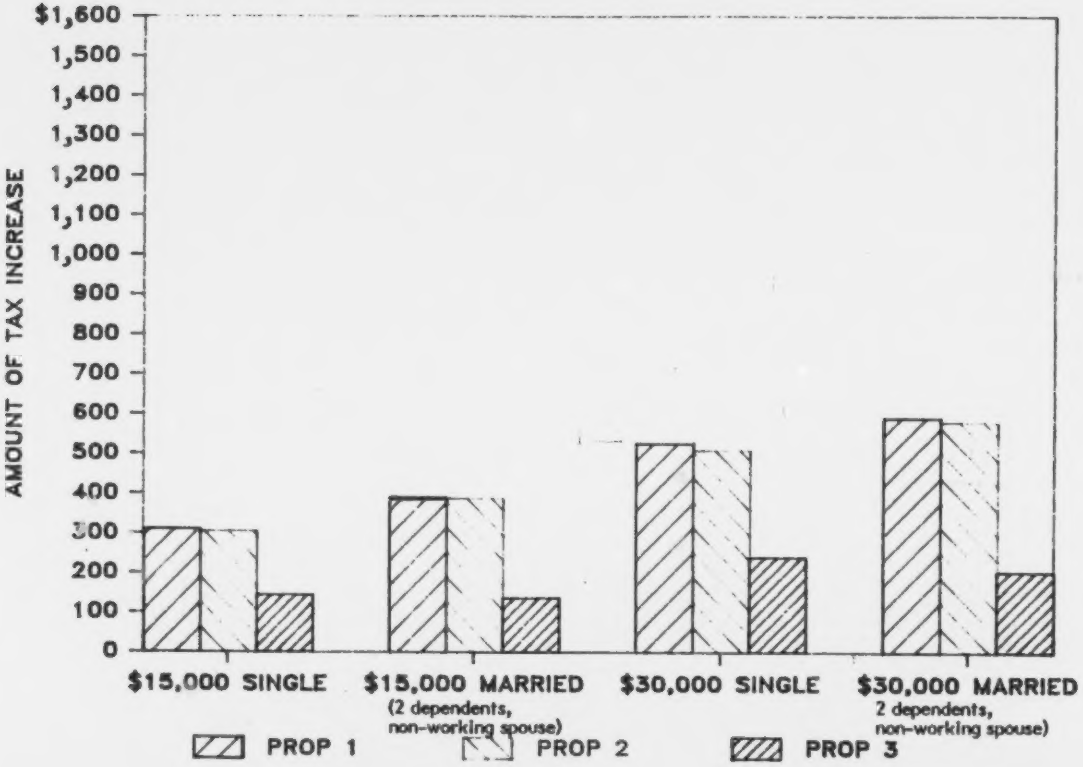
INCREASE IN FEDERAL INCOME AND SOCIAL SECURITY TAX FOR A TYPICAL MICHIGAN STATE EMPLOYEE UNDER THREE DIFFERENT TAX PROPOSALS



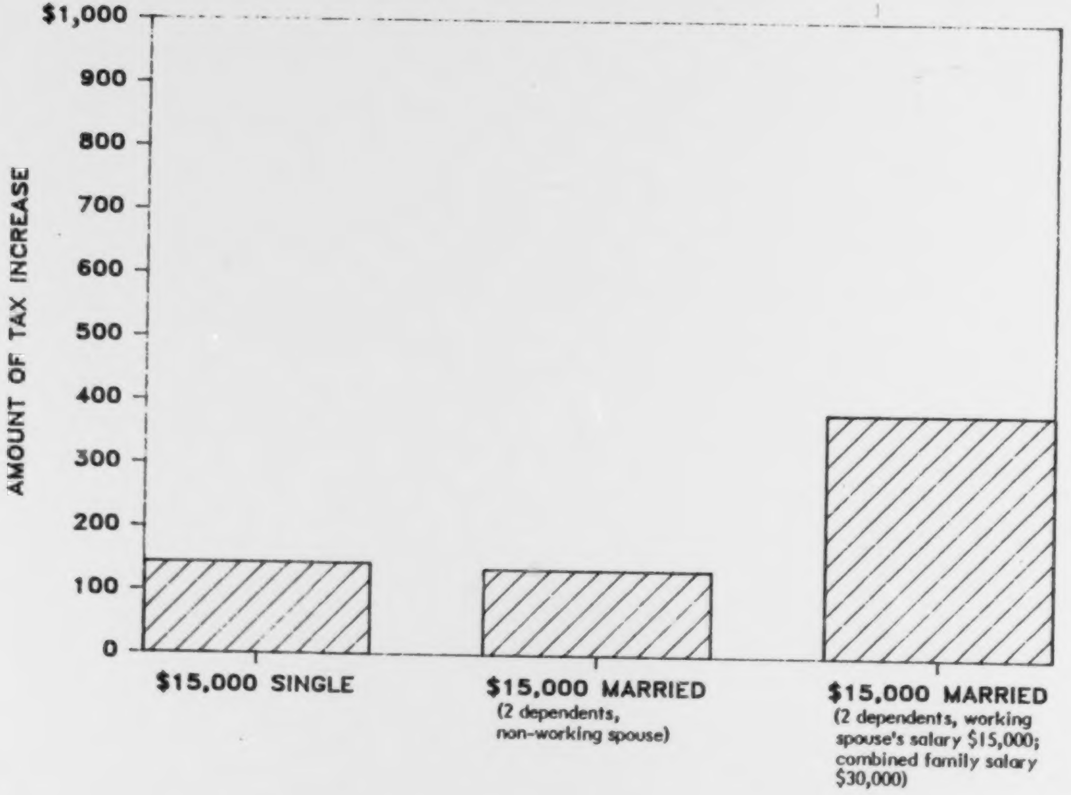
INCREASE IN FEDERAL INCOME AND SOCIAL SECURITY TAX FOR A TYPICAL MICHIGAN STATE EMPLOYEE UNDER TREASURY TAX PROPOSAL



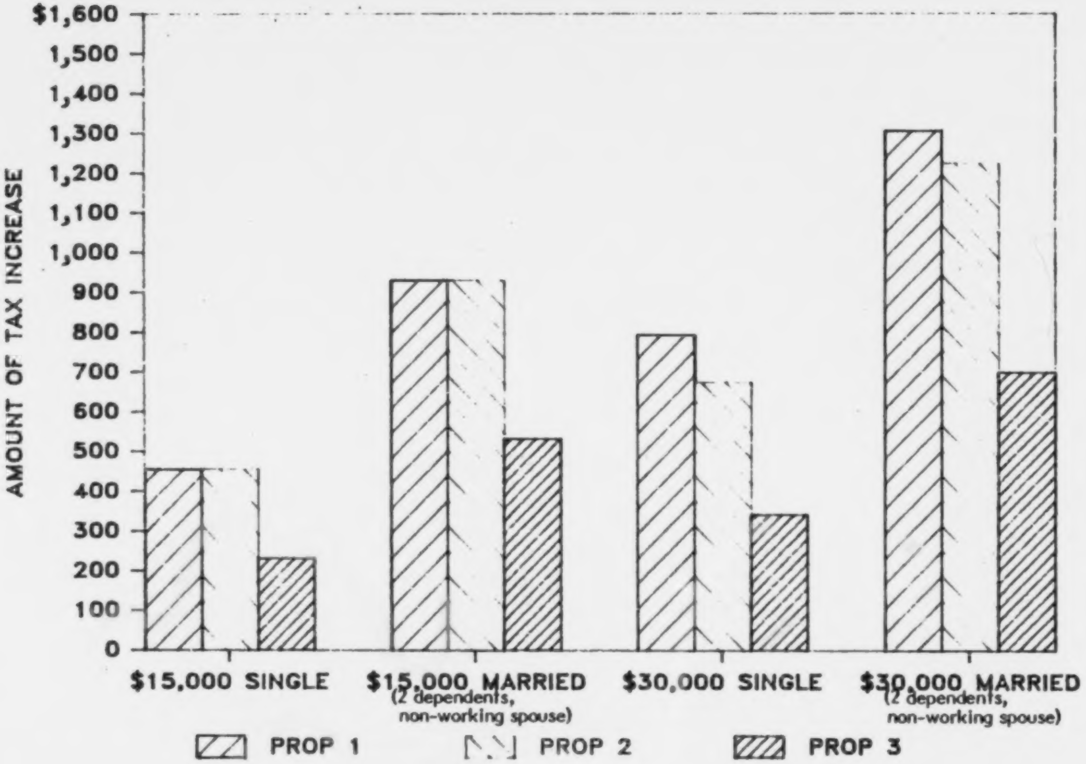
INCREASE IN FEDERAL INCOME TAX
FOR A TYPICAL COOK COUNTY EMPLOYEE
UNDER THREE DIFFERENT TAX PROPOSALS



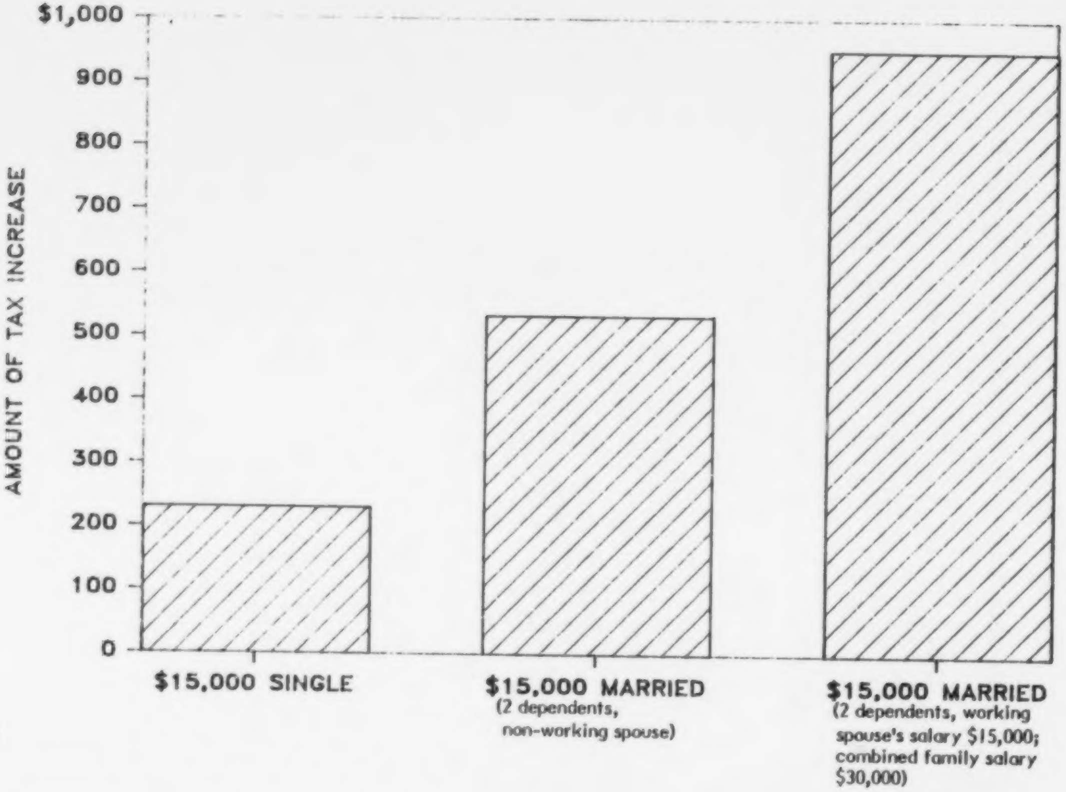
INCREASE IN FEDERAL INCOME TAX
FOR A TYPICAL COOK COUNTY EMPLOYEE
UNDER TREASURY TAX PROPOSAL



INCREASE IN FEDERAL INCOME AND SOCIAL SECURITY TAX FOR A TYPICAL UNIVERSITY OF CALIFORNIA EMPLOYEE UNDER THREE DIFFERENT TAX PROPOSALS



INCREASE IN FEDERAL INCOME AND SOCIAL SECURITY TAX FOR A TYPICAL UNIVERSITY OF CALIFORNIA EMPLOYEE UNDER TREASURY TAX PROPOSAL



Unlike their counterparts in the private sector who are protected by ERISA, state and local government workers have virtually no federal retirement income protections. It does not seem an unusual notion that the assets of any pension plan "belong" to its participants, that the assets should be invested for the "exclusive benefit" of the plan's participants and beneficiaries, and that individuals who control those assets should be held under law to a high standard of behavior. In fact, all this is the case in the private sector. Unfortunately, it is by no means a settled proposition in the public sector. Conflicting and ambiguous state and local laws and court decisions have created much uncertainty about the legal rights of participants in public pension plans.

As a constructive means of addressing the public pension crisis, the American Federation of State, County and Municipal Employees (AFSCME) strongly supports the enactment of minimum federal reporting and disclosure and fiduciary standards for state and local government retirement systems. By focusing on these areas, such legislation will minimize the degree of federal intrusion in state and local government affairs. Effective reporting and disclosure and fiduciary standards will ensure that state and local pension problems are solved at home, rather than in Washington, D.C.

At a time when a debate is getting underway on the formation of a national industrial policy and the use of pension assets as an integral component of that policy, the enactment of strong reporting and disclosure and fiduciary standards for state and local plans becomes even more important.

Gerald McEntee
President
American Federation of State, County
and Municipal Employees.

Introduction

Currently, Congress is considering the Public Employee Pension Plan Reporting and Accountability Act (PEPPRA), legislation that would establish reporting, disclosure, and fiduciary standards and administrative and enforcement procedures for this nation's 6,600 state and local pension plans.

Over 13 million retired and active state and local government employees depend on these plans to provide them with income security upon retirement. The absence of uniform standards governing these plans has left the retirement income security of millions of state and local employees in doubt. Moreover, state and local government taxpayers will ultimately pay the price for fund mismanagement.

State and local government employees forgo billions of dollars in wages and other forms of compensation each year in order to participate in these pension plans. But, they do not enjoy the same rights and protections as their counterparts in the private sector.

Currently, the pension funds for state and local employees hold over $260 billion in assets. They are predicted to grow at a rate of nearly $30 billion per year for the next five years. These pension funds are an important source of capital for the states in which they reside and the nation as a whole. Yet the management of these funds is often characterized by conflict of interest, restrictive state laws, political manipulation, and unprofessional portfolio management. Attempts at reform are too often thwarted by local business or political interests.

PEPPRA does not propose to regulate all aspects of state and local pension plans. Instead, PEPPRA seeks to reform practices of these plans with a minimum of federal intervention. The Act would provide for:

- federal reporting and disclosure standards;
- federal fiduciary standards;
- administrative and Enforcement Procedures; and
- creation of an Advisory Council on Governmental Plans.

Experience with private pension plan regulation has shown that adequate and uniform reporting and disclosure standards are the least intrusive and most effective way to reform pension abuse. Federal standards are necessary to ensure comparability of data from plan to plan and state to state.

PEPPRA seeks to apply the same fiduciary standards found in the Employee Retirement Income Security Act (ERISA) to state and local pension fund management. These standards have proved to be effective in significantly reducing abuse in the management of private pension plan assets. Government sponsors and plan participants would benefit from nearly a decade of case law and enforcement experience if these standards were applied to state and local plans as well.

PEPPRA is silent on many standards important to state and local pension reform: participation, vesting, funding, limits on benefits or contributions, and survivor benefits. In addition, no mention is made of two potentially troublesome public policy issues: plan termination insurance, and social security coverage.

The legislation does provide for the establishment of an Advisory Council on Governmental Plans. In its proposed form, this Council promises to be yet another toothless governmental advisory group. If, however, Congress gave this group independence from the Administration, as well as an adequate staff and budget, the Advisory Council could become a catalyst for continued state and local reform. If the Council were successful in its efforts, further federal action might be unnecessary.

In its current draft, certain compromises were made to reduce state and local government opposition to PEPPRA's passage. One unfortunate compromise allows governors to exempt plans in their states from the reporting and disclosure requirements if state or local laws or regulations are "substantially equivalent" to PEPPRA's. When it comes to disclosing key investment, accounting, and actuarial information, the data must be calculated on the same basis in order to be of any value. Disputes over the meaning of the term "substantially equivalent" could very well render the reporting and disclosure provisions of PEPPRA "substantially useless."

In spite of its deficiencies, PEPPRA represents an important step toward reform of the nation's state and local pension plans. A few key amendments would greatly increase its effectiveness. Involvement of important state and local organizations in the activities of a strengthened Advisory Council on Governmental Plans would ensure that the reform process begun by PEPPRA will continue without further federal intervention. Enactment of the reporting and disclosure standards outlined in the legislation would provide solid guarantees both for plan beneficiaries and for the average taxpayer.

In summary, the following points and conclusions can be made:

- the management of the nation's 6,600 state and local government public employee pension funds often produces conflicts of interests, unprofessional portfolio management and political manipulation.
- there is an absence of uniform reporting and disclosure standards which make evaluations of state and local plans difficult, if not impossible.
- legislation now being considered by the Congress would be an important step in assuring that the policymakers, the taxpayer and the plan beneficiaries in state and local government are fully appraised of financial conditions and the management of public employee plans which hold $260 billion in assets.

Public Employee Retirement Plans

Public employee retirement plans are extremely diverse. The single most comprehensive study of state and local pension plans remains the report of the House Pension Task Force in 1978. Since that time, a number of other detailed studies have been conducted by several executive branch agencies, the President's Commission on Pension Policy, and a number of state and local organizations. In general, these additional studies have tended to confirm the findings of the House Pension Task Force.

In all, there are 51 federal plans and approximately 6,630 state and local pension plans.[1] Since federal law (PL95-595) governs reporting and disclosure for federal plans, only the state and local plans would come under regulation if PEPPRA were enacted. Approximately 13 million current employees and retirees are covered by these plans.[2]

Most of the 6,630 plans are relatively small: according to the House Pension Task Force report, approximately 75% of the plans cover fewer than 100 workers, while only 2% cover over 10,000 workers.[3] However, most employees are covered by large plans: nearly 70% of the employees are covered by the largest 100 plans.[4]

Administration of these plans is also fragmented. According to the Task Force report, 9.6% of the plans are administered by states, 59.5% by cities, 4.6% by counties, 22.6% by townships, and 3.8% by special governmental districts (such as transit authorities).[5]

The following table shows the percentage distribution of covered employees by employment category.

TABLE I
DISTRIBUTION OF RETIREMENT SYSTEM ACTIVE EMPLOYEES BY EMPLOYMENT CATEGORY

Category	Percentage of Employees
Federal	1
State	22.8
Local	26.7
Police and Fire	6.7
Teachers	[illegible]
Teachers (higher education)	[illegible]
Other	[illegible]
Total	100.0

(Source: [illegible] Task Force Report, p. 58)

This table shows that teachers make up the largest single block of public employees covered by pension plans. While police and fire pension plans make up over 66% of all state and local pension plans,[6] they only represent 6.7% of all employees. Most police and fire pension plans are relatively small.

Administration of these pension plans is somewhat fragmented, even though over 40% of the plans have realized some economies through administration by multiple governmental bodies.[7]

Both the House Pension Task Force in 1978 and the President's Commission on Pension Policy in 1981 concluded that most governmental bodies have failed to develop comprehensive pension policies. This failure has led to a hodgepodge of programs that provide overly generous benefits to some and inadequate benefits to others. Inadequate funding policies have led some municipalities and states to either reduce pension benefits or seek new tax revenues for pensions already promised.

Since 1978, a number of states, as well as a number of state and local organizations, have created special commissions, task forces, and study groups to propose state and local pension reform. Some states have formed permanent retirement commissions to monitor the operations of pension systems. About 70% of the plans are administered by either an investment board or a retirement board. In general, these boards exercise full authority in investing plan assets.

Foremost among the national groups proposing pension reform have been the Municipal Finance Officers Association (MFOA), the National Governor's Association (NGA), and the National Conference of State Legislators (NCSL). While these groups have generally agreed with the need for reform, they have suggested that federal regulation is not the solution. Instead, they have conducted studies leading to "guidelines" for state and local governments to follow on a voluntary basis.

Some states have attempted to move from the "guideline" stage to implementation, with mixed results. In a few states, like California, heated political battles over reform legislation have produced mixed results. In that state, improvements in fiduciary standards have been signed into law. However, recently, the state's governor vetoed an important piece of legislation designed to take the portfolio management of the state's pension assets out of the political arena and to require full reporting and disclosure. The case of California demonstrates the difficulty of state and local pension reform at the local level.

Most state and local pension plans provide salary and service-related benefits of the defined benefit type. While most of these plans meet ERISA's age, vesting and service requirements, police and fire pension plans tend to have more restrictive vesting schedules.

Approximately 70% of state and local employees covered by pension plans are also covered by social security, as the following table shows. Police and fire employees and teachers are much less likely to be covered by social security than other employees.

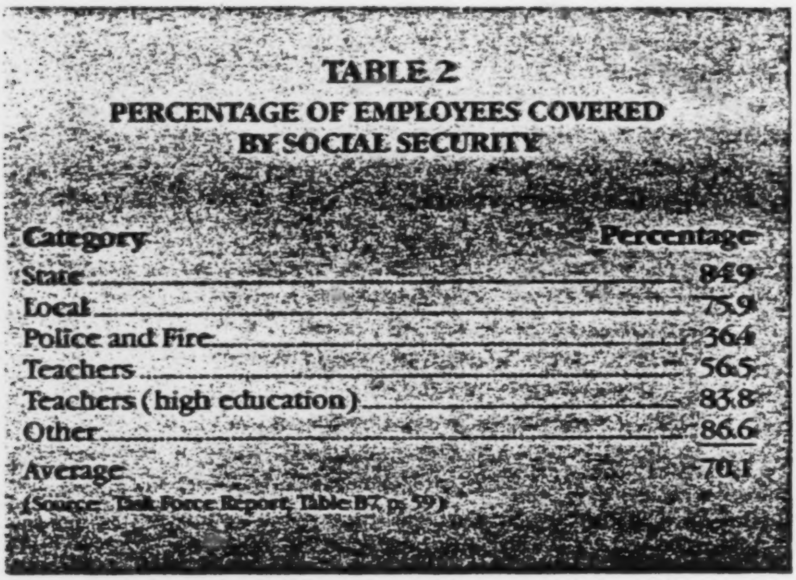


TABLE 2

PERCENTAGE OF EMPLOYEES COVERED BY SOCIAL SECURITY

Category	Percentage
State	84.9
Local	75.9
Police and Fire	36.4
Teachers	56.5
Teachers (high education)	83.8
Other	86.6
Average	70.1

(Source: Task Force Report, Table B7, p. 59)

Pension Funds As Economic Institutions

In addition to providing benefits to employees, state and local pension plans are an important source of capital for the economy. Prudent management of these funds is important to both the beneficiaries of the pension trusts and the taxpayers supporting the plans. Table 3 shows how these plans' assets are predicted to grow in the future.

TABLE 3

PENSION PLAN ASSETS (ANNUAL INCREASE)

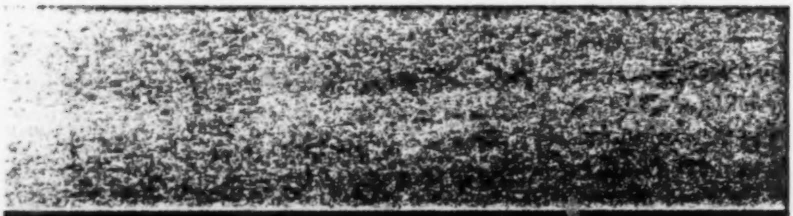
(Market value at year end in $ Billions)

Type	1983	1984	1985	1986	1987
Defined Benefit	761	838	951	1,036	1,185
Corp.	424	471	538	589	678
State & Local	260	283	318	344	387
Multi-Employer	65	71	79	86	98
Non Profit	13	14	16	18	21
Defined Contribution	228	265	314	348	406
Corporate	184	215	255	283	331
Nonprofit	44	50	59	665	75
DB & DC Total	989	1,103	1,265	1,384	1,591

Source: ICP, Inc.

Currently, state and local pension plan assets exceed $260 billion and are predicted to grow by approximately $30 billion annually over the next five years. The size of these pension funds ranges from very small plans with under $100,000 in assets to the largest system, California, covering thousands of employees with over $28 billion in assets.

While the growth of these funds may be a measure of increased retirement income security for participants and beneficiaries, it also suggests a danger: the very size of these funds makes them easy targets for diversion to purposes other than providing a proper rate of return to finance benefits.



Inadequacy of State And Local Regulation

Between 1979 and 1981, the President's Commission on Pension Policy reviewed the findings of the House Pension Task Force Report, initiated and coordinated new research on state and local pension plans, and held hearings around the country on problems with these plans. The final report of the President's Commission agreed with the House Pension Task Force that problems exist in the following areas: participation, vesting, reporting, disclosure, funding standards, fiduciary responsibility, limits on benefits or contributions, survivor benefits, and plan termination insurance.

Ironically, inadequate reporting and disclosure have hampered the development of conclusive research in some of these areas. However, enough is now known about some problem areas to suggest the need for immediate reform.

Inadequate Fiduciary Standards

Prior to the establishment of ERISA, private sector employees had to rely on state and local laws to protect them from abuse by plan administrators and trustees. Pension experts universally agree that the establishment of uniform fiduciary standards by ERISA has had a major influence on ending pension fund mismanagement. Both the President's Commission and the Pension Task Force concluded that public employees need this same protection.

The absence of uniform fiduciary standards has led to abuses such as conflicts of interest in management, and unprofessional investment practices. In the words of the Pension Task Force report: "There is virtual unanimity within the pension community that those who have control of pension assets should be held to high standards of behavior and should face liability upon failing to satisfy that standard . . . throughout the universe of state and local government retirement systems there is a virtual absence of clear guidelines in this vital area."[8]

A study conducted by Louis Kohlmeier for the Twentieth Century Fund documents widespread conflicts of interest in the management of state and local pension funds: "One of the most persistant conflict-of-interest situations in the management of public pension funds results from the policy, followed by many plans, of hiring local bankers, brokers and investment advisors and the practice of investing in local securities, even though better or lower cost services and higher yielding investments may well be available outside local boundaries."[9]

Some of this activity is well-intentioned: legislators and plan administrators sometimes seek to encourage local business. Often, state law will specify that certain types of investments, such as mortgages or municipal bonds, must make up a fixed portion of the pension portfolio. In addition, some state laws exclude investments in certain financial instruments such as corporate stocks.

Whether or not well-intentioned any sacrifice in investment return due to these restrictions may not be in the interest of either the beneficiaries of the pension plans or the taxpayers that support them.

Another area of fiduciary abuse highlighted by both the Pension Task Force Report and the Kohlmeier study concerns the absence in many states of professional investment management. Frequently, pension fund trustees are nonexpert in the field of portfolio management. This "often produces investment policies and practices that are significantly less valuable than that expected from professional investment advisors and managers, and generally found in private sector plans."[10]

In spite of the number of reports calling for changes in state and local fiduciary practices, local reform has been extremely slow, and the prospects for significant changes in the near future seem remote.

Even the experiences in states that have made moderate progress in pension reform illustrate the dangers of relying on that process for significant change. The battle for reform of California's fiduciary, investment management, and reporting and disclosure practices provides a current example.

For the past several years, the state legislature has been debating reform of the management practices of California's two large public employee pension funds, totaling over $28 billion in assets. A Joint Committee on Public Pension Fund Investments has, for the past two years, hired consultants, held hearings, conducted studies, sought the advice of experts throughout the country, and drafted legislation.

Consultant reports to the Committee found that the funds were difficult to oversee due to inadequate reporting and disclosure, that fund administration was not insulated from the political process, that portfolio performance suffered from the quality and quantity of resources devoted to investment staff, and that guidelines for trustee behavior did not exist.[11] The major consultant to the Committee, Dr. Marcy Avrin, reported that the taxpayers of California could save hundreds of millions of dollars per year by increasing the return of the pension portfolio to reasonable levels.[12]

The bills that were presented to the state legislature by the Joint Committee in 1982 and 1983 have been nearly universally praised by pension and investment experts.[13] At first it seemed successful passage of these bills was ensured. In 1982 an important breakthrough was made with the enactment of an ERISA-like prudence standard. However, when the legislature attempted to add teeth to this provision, with passage of a bill adding a comprehensive reporting and disclosure provision and separating the investment board from executive branch and legislative influence, the governor vetoed the bill.[14] Even if the legislature eventually prevails, this veto illustrates the difficulty of significant pension reform on the state and local level. It is unlikely that most states and municipalities will devote the time and resources for reform that California has.

By their very size relative to the budgets of their governmental sponsors, public pension funds are easy targets for budgetary and political manipulation.[15] Politicians are unlikely to relinquish their control over these funds voluntarily. Furthermore, full disclosure may lead to embarrassing reports of underperformance by political appointees. As long as the disclosure of this performance can be hidden or delayed, those responsible will not be held accountable.

Inadequate Reporting And Disclosure

Virtually every major study of state and local reporting practices has found serious inadequacies. Frequently, important financial, actuarial, and accounting calculations are either not performed or not revealed. In many instances, plan participants are not even informed of their basic plan benefits and legal rights through simple summary plan descriptions.

Most experts agree that complete reporting and disclosure of financial and benefit information is the least intrusive way to reduce abuse by pension trustees and plan administrators. Due to the highly complex nature of pensions, inadequate disclosure makes it impossible for even experts to detect abuse or mismanagement until it is too late: when pension promises are broken or additional taxes must be raised to prevent insolvency.

This point was emphasized by Louis Kohlmeier in his study of asset management practices: "Most public pension plans make financial reports of some kind to the legislature, to the governor or mayor, to employees and/or the general public. The great majority of such disclosures are wholly inadequate to allow legislators, employees or the public to judge the inadequacy of fund administration. . . . Rarely do reports disclose [investment information capable of being analyzed].[16]

In 1978, the House Pension Task Force concurred when it concluded that the "potential for abuse is great due to the lack of independent and external reviews of the operations of many plans."[17]

Late in 1978, the newly established President's Commission on Pension Policy began to coordinate an interagency research effort on state and local pension plans that resulted in three major reports in 1980 and 1981. Each of these reports confirmed this conclusion by the House Pension Task Force.

The first report, conducted by the Urban Institute, examined a sample of 100 large pension plans. While these plans are generally considered to have the best reporting and disclosure of all state and local plans, Table 4 shows that even they have serious gaps in disclosure.

TABLE 4

Frequency of Disclosure of Particular Items in Annual Reports

Item	Percentage of Plans Including
Auditor's opinion	40
Report of assets, liabilities, etc.	99
Statement of changes in reserves	54
Statement of factors (e.g., litigation and trends) that may affect financing and operation	33
Statement of investment policies and restrictions	47
Portfolio by asset type	93
Funding policy for employers and members	58
Date of last actuarial report	65
Changes in actuarial assumptions	23
Summary of actuarial assumptions	37
Amount of liability (actuarial balance sheet)	71
Number of former employees vested but not yet getting benefits	43
Number of beneficiaries	86

Source: Technical Appendix, *Coming of Age: Toward A National Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 606.

Annual reports should contain complete accounting, actuarial, and financial information. However, the federally sponsored Urban Institute study showed a number of deficiences. Only 40% contained an auditor's opinion, and only 33% contained a statement of factors that might affect financing and operation. While 99% contained a statement of assets and liabilities and 71% contained an actuarial balance sheet, only 37% disclosed actuarial assumptions used to perform the calculations, and only 23% disclosed changes in actuarial assumptions that might affect year-to-year variations in the reported numbers. Without these further disclosures, the other figures are virtually meaningless even to experts.

Disclosure of adequate investment criteria and performance was also found lacking: only 47% disclosed even a statement of investment policies and restrictions.

The second product of the federal pension research effort was a report issued in 1981 by SRI International on small- and medium-sized state and local pension plans. Table 5 shows a summary of SRI's reporting and disclosure findings.

TABLE 5

Availability of Information on Plans

Type of Document	Document Exists (%)	Document Available to Employees (%)	Document Available to the Public (%)
Descriptive booklet for participants	58.0	49.3	40.7
Law, ordinances or code	71.3	66.7	63.3
Recent annual report	92.0	84.7	77.3
Recent actuarial report	88.0	77.3	70.0
IRS 5500G form	92.7	83.3	76.0

Source: Technical Appendix, *Coming of Age: Toward a National Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 608.

According to the report, fewer than half the employees have a booklet describing the benefits and eligibility criteria for their plans. Other documents such as annual reports, actuarial reports, and ordinances governing the plans are too often available to neither the employees *nor the public.*

The third report of the federal research effort was a report on financial reporting and disclosure prepared by the Municipal Finance Officers Association. They concluded that "available information indicates such reporting is today inadequate and confused and clearly in need of repair. Several factors contribute to the lack of good disclosure about [state and local] pension systems. . . ."[18] Further, the MFOA concluded that these deficiencies were due to a "lack of general authoritative standards for system disclosure and of enforcement of such standards that do exist."[19]

Inadequate Funding Standards

The reporting and disclosure evidence that is available indicates that a potentially serious problem exists with regard to inadequate funding of state and local pension plans. Whether the failure to disclose funding policies means that none exist or that the plans may fall into insolvency is difficult to discern.

Part of the federal research effort referred to earlier involved an attempt to estimate the funding status of state and local pension plans. The findings of this effort show a mixed picture:

(1) Large plans, in the aggregate, appear reasonably well funded;

(2) Some large plans face funding problems;

(3) Small plans cannot be easily evaluated due to inadequate reporting and disclosure;

(4) Small plans appear very vulnerable since many are dependent on outside sources of funds for their annual contributions.

The research project attempted to evaluate large pension funds by simulating their plans' experiences using actuarial cost models developed by Howard Winklevoss Associates. The models showed that the large funds studied seemed to be funding according to reasonable schedules if they were viewed as a whole. However, when viewed separately, some plans, particularly police and fire plans, appeared to face potential problems in the future.

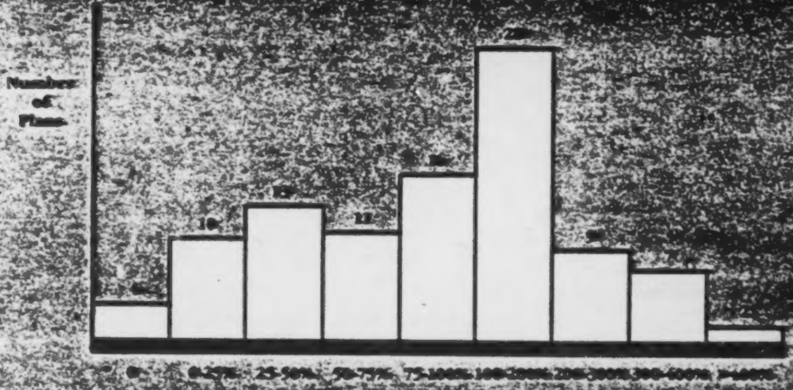
Table 6 shows one way of assessing the funding status of these large pension plans. The current and estimated funding status is measured by dividing the unfunded liability of each plan by the total payroll cost for the current year (1980) and the final forecast year (2024). The table shows that under current funding strategies, only 52% of the plans would be fully funded by 2024 even if no improvements are made in benefit formulas and no ad hoc benefit increases are made for the entire period.

TABLE 6

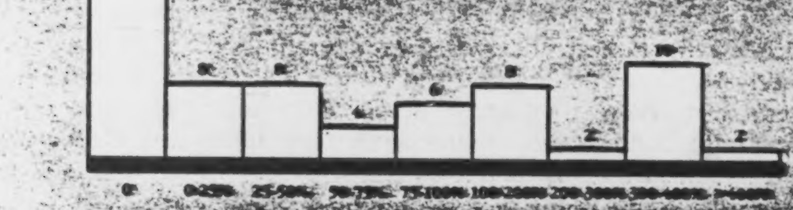
DISTRIBUTION OF UNFUNDED LIABILITY AS PERCENTAGE OF PAYROLL FOR PLANS IN THE 100 PLAN SAMPLE

[illegible]

Initial Year



Final Year



Source: Technical Appendix, *Coming of Age: Toward a National Retirement Income Policy,* President's Commission on Pension Policy, 1981, p. 685.

Table 7 shows a potential problem for small state and local pension plans: their dependence on other sources for their annual pension contribution. According to this table very small municipal plans are particularly vulnerable. In an era when state and federal aid is being severely curtailed, this table provides reason for concern.

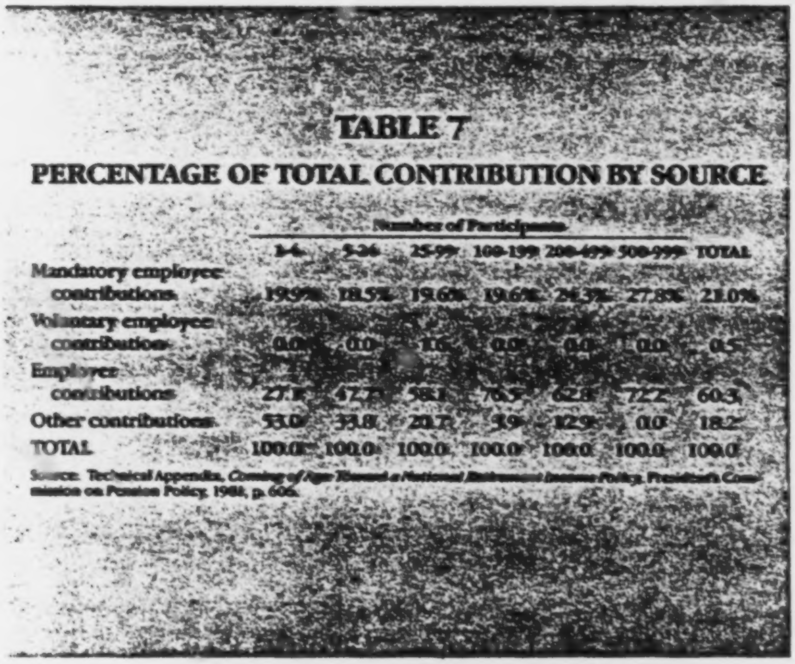


TABLE 7

PERCENTAGE OF TOTAL CONTRIBUTION BY SOURCE

	Number of Participants						
	1-4	5-24	25-99	100-199	200-499	500-999	TOTAL
Mandatory employee contributions	19.9%	18.5%	19.6%	19.6%	24.3%	27.8%	21.0%
Voluntary employee contributions	0.0	0.0	1.6	0.0	0.0	0.0	0.5
Employer contributions	27.1	47.7	58.1	76.5	62.8	72.2	60.3
Other contributions	53.0	33.8	20.7	3.9	12.9	0.0	18.2
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Technical Appendix, *Coming of Age: Toward a National Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 606.

While the federal research projects do not provide conclusive proof of a national underfunding problem for state and local pension plans, they do offer evidence of pension plan vulnerability to changes in benefit policies, interest earnings, contribution sources, state and federal budgets, and many other factors that are likely to affect them. Better reporting and disclosure would permit future research efforts to determine whether the funding problems faced by some pension plans are sufficiently widespread to warrant federal standards.

Does PEPPRA Go Far Enough?

Congressional interest in legislation regulating state and local government pension plans dates back to the debates preceding enactment of the Employee Retirement Income Security Act (ERISA). Initially, public pension plans were included in the ERISA bills under consideration. The final legislation that was passed in 1974, however, called only for a congressional study of these plans and the need for federal legislation. The House Pension Task Force report that was issued in 1978 was the product of that congressional effort.

Since the issuance of that report, some form of federal legislation governing state and local pension plans has almost continuously been before the congress. In the 97th Congress, H.R. 4928 and H.R. 4929, the Public Employee Retirement Income Security Act (PERISA), were introduced by Representatives Phillip Burton, Chairman of the House Labor-Management Subcommittee, and John Erlenborn, ranking minority member of the Education and Labor Committee. Identical measures (S.2105 and S.2106) were introduced in the Senate in February by Senator John Chafee, Chairman of the Finance Subcommittee on Savings, Pensions and Investment Policy. The President's Commission on Pension Policy supported the legislation, though it believed that federal regulation of funding and benefit standards should also be included in any such bill.[20]

After state and local government officials raised certain objections at hearings on the bills in February, 1983, the legislation was rewritten with several "deregulatory" provisions. The new legislation, called "The Public Employee Pension Plan Reporting and Accountability Act (PEPPRA), was reported out of the House Education and Labor Committee with only one dissenting vote.

As rewritten, PEPPRA would require reporting and disclosure of certain benefit, financial and actuarial information, as well as establish fiduciary standards and enforcement procedures. States are granted an exemption from certain provisions if the state's governor certifies that state laws have "substantially equivalent" provisions.

Reporting and Disclosure

Professor Roy Schotland of the Georgetown Law School provided a good summary of the importance of federal reporting and disclosure standards when he testified on S.2105 and 2106 on March 29, 1982:

"1. **Effective disclosure activates local political processes, so that pension problems are more likely to be worked out at home.**

2. Disclosure cannot be effective unless local taxpayers and pension participants can **compare** how their funds are doing relative to other similar funds.

3. **Only the federal government can assure comparability** of information about pension plans.

4. **Required disclosure is the least intrusive and least costly form of regulation.** This makes it especially appropriate when, as here, the federal government must take some steps affecting state and local governments in order to protect the federal taxpayers' vulnerability as pension insurer of last resort."[21]

PEPPRA attempts to provide requirements for disclosure of plan information to participants and reporting of accounting, actuarial and investment data to participants, the government, and the public. Unfortunately, the "deregulatory" amendments may have seriously weakened these provisions. In addition, the requirements for investment performance may need elaboration.

Reporting to Participants

PEPPRA requires that a Summary Plan Description (SPD) be provided to participants and beneficiaries. Pension plans are usually a complex form of employee benefit and may have numerous rules and criteria for benefit eligibility. The PEPPRA bills specify twelve items that must be included in the reports to apprise beneficiaries of their rights and obligations under the plans. The bills specify that the SPD must be written in language understandable to the beneficiary population, a formidable task. These requirements seem reasonable and in keeping with private sector practice.

In addition, plan administrators are required, upon request, to provide participants information regarding total accumulated plan benefits, accumulated employee contributions (with interest), and vesting status. This information would be automatically provided all employees who terminate employment with vested benefits.

The Annual Report

The Annual Report is the only document that must include among other things, complete accounting, actuarial, financial and investment information.

The actuarial reporting requirements in PEPPRA reflect Department of Labor (DOL) regulatory changes made in 1978 in ERISA's actuarial reporting requirements as well as requirements suggested by the Financial Accounting Standards Board (FASB) for all plans. In 1978, both the DOL and FASB proposed that plans disclose present value calculations for accrued plan benefits (based on service to date and current salary) using a single actuarial cost method with full disclosure of major explicit actuarial assumptions. In addition both DOL and FASB proposed that these values should be calculated with salary projections.

The DOL eventually dropped its proposal to require salary projections due to claims made by a number of actuaries about the burden of doing so. While FASB concurred at the time, it has since proposed that this projection be included in a plan's financial statements. Plan experience since 1979, when the DOL regulations first took effect, has shown that the calculations of these figures are not "burdensome."

The PEPPRA requirement for the so-called "credited projected benefits" accomplishes what both the DOL and FASB sought in their original proposals in 1978. These salary projections are particularly appropriate for state and local plans since most plans calculate benefits based on either career average or final average salary.

In addition, PEPPRA section 107(d)(1) requires that "the enrolled actuary shall utilize on an explicit basis such assumptions and methods as are necessary. . . ." Also, paragraph (d)(2) states that "the actuarial statement shall include actuarial assumptions and methods, plan provisions, and other pertinent factors on the actuarial position of the plan."

Once again, PEPPRA has incorporated DOL regulatory reform and FASB guidelines into the language of the bill. Actuaries have argued that they should be free to use either "explicit" or "implicit" actuarial assumptions. What is an "explicit" assumption? Disclosing "explicit" assumptions merely means that all assumptions are individually related to the expected experience of the pension fund. For example, the use of a 7.5% interest rate assumption means that the actuary is predicting that the rate of return of plan assets for the forecast period will be 7.5%. What then is an "implicit" assumption? An actuary may take the same 7.5% expected investment yield figure and make unspecified "adjustments" due to other factors not taken into account by the other assumptions used (such as employee turnover). The use of implicit assumptions defeats the purposes of actuarial disclosure: comparability of data from year to year and between plans and the ability of experts (other than those who perform the report's calculations) to evaluate the performance of the plan.

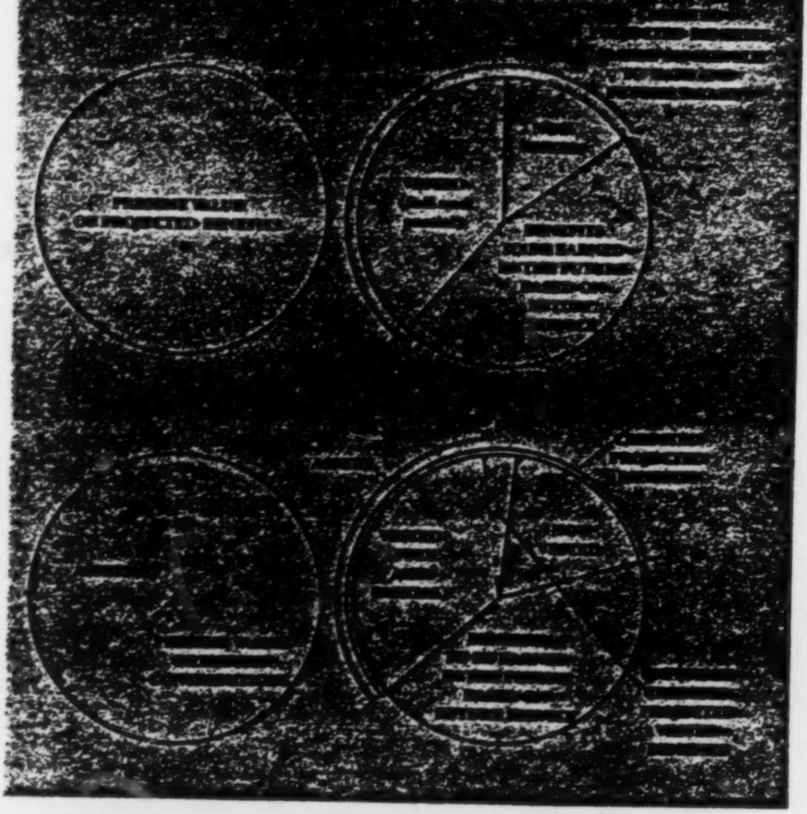
As written, PEPPRA appears to require only disclosure of explicit assumptions for the "actuarial present value of credited projected benefits" figures. This requirement should extend to all actuarial calculations.

While PEPPRA's accounting and actuarial reporting requirements seem reasonably complete, the bill as written lacks any definitive requirement for reporting investment performance. As with ERISA, PEPPRA's disclosure requirements in this area appear to be designed more for enforcement of the prohibited transactions fiduciary standards than for evaluation of investment performance.

Earlier, California's experience with pension reform was briefly reviewed. This past summer, the legislature passed AB 672, which, among other things, called for full disclosure of in-

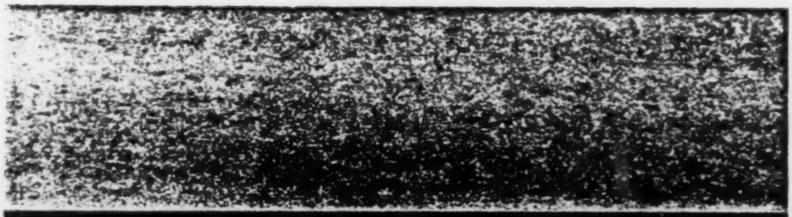
FIGURE 1

GRAPHIC PRESENTATION OF ACTUARIAL DISCLOSURE UNDER PEPPRA



vestment performance. The bill was vetoed by the governor. Supporters believe that one reason for the veto was that the investment performance disclosure would have exposed serious shortcomings in the management of that state's two pension fund portfolios. Financial experts praised the standards as both complete and reasonable for evaluating a fund's investment performance. Such a requirement is clearly needed as an amendment to PEPPRA. For that reason, the relevant portions of AB 672 are included as an appendix to this report for consideration by Congress and those reviewing PEPPRA.

PEPPRA would permit an assessment of whether current plan assets are sufficient to pay anticipated benefit obligations. In Figure 1, the "unfunded credited projected vested benefits" calculation shows the degree to which plan assets are insufficient to pay benefits already earned by employees, assuming that the current plan continues until they retire.



"Substantially Equivalent" Provisions

As a compromise, the writers of PEPPRA have provided in section 102 that a state's pension plans can be exempted from the specific reporting and disclosure requirements if the governor of that state determines that its own laws are "substantially equivalent." What this term means in the context of numerical information is not at all clear. Even minor deviations in factors such as time periods, method of calculation, inclusion and disclosure of various assumptions, etc., would render this title of the act "substantially useless."

Language could be added to this provision to restrict its application to only the more qualitative requirements of the reporting and disclosure title. The comparability of the key financial, investment, and actuarial data must be preserved if PEPPRA's reporting and disclosure provisions are to have any meaning.

Fiduciary Standards

PEPPRA applies the same basic fiduciary rules found in ERISA to state and local pension plans. Fiduciaries must act solely in the interest of beneficiaries and participants and must use funds for the exclusive purpose of providing benefits and managing the funds. The bills also provide for identical prudence and prohibited transactions rules.

One fiduciary provision is more restrictive than ERISA's. While ERISA limits the acquisition of employer securities to 10% of total assets, PEPPRA would limit this to 5%. As Roy Schotland pointed out in testimony in 1982, state and local pension holdings of such securities have not approached 5% in the past twenty years. Disregarding New York City funds from these calculations reduces this figure to under 2.5% for the past decade. Schotland went on to propose that the ceiling be "2.5%, with provision making clear that existing holdings are "grandfathered" and with legislative history making clear that special situations, like New York's ... shall be treated as that situation was, by special exception with safeguards to protect the federal interest in tax-favored pension funds."[22]

By adopting ERISA's fiduciary standards, all state and local pension plans would come under the same rules that private plans have enjoyed since its enactment. Taxpayers and plan participants alike would realize savings of time and money since the courts and enforcement agencies could refer to nearly a decade of case law and regulations for guidance.

Advisory Council on Governmental Plans

While PEPPRA has made major strides in reform of reporting and disclosure and fiduciary standards for state and local plans, it is silent in regard to funding, vesting, participation, survivor benefits, social security coverage and plan termination insurance. PEPPRA provides that an Advisory Council on Governmental Plans be created to monitor the implementation of PEPPRA and to suggest any amendments that might be needed to the President and to Congress. Furthermore, section 307(c) states: "The Council may establish voluntary guidelines for plans with respect to matters for which requirements are not established by this Act."

The authors of PEPPRA have patterned this advisory council after the ERISA Advisory Council. Like the ERISA Council, the Governmental Plan Council would be totally dependent on the Secretary of Labor for staff support and research. Experience with the ERISA Advisory Council has shown that this arrangement does not work. Since its inception, the ERISA Advisory Council has been given little staff support and has been largely ignored by the Secretary and the ERISA Administrator. In addition, this Administration has shown no interest in funding even the most basic pension research.

The concept of an Advisory Council on Governmental Plans is a good one. An independent body should review the implementation of this law. Furthermore, the input from state governmental officials, labor representatives, and pension experts could help smooth the regulatory process.

The Advisory Council on Governmental Plans could work with the Municipal Finance Officers Association, the National Governors Association, the National Conference on State Legislatures, and others, to encourage the implementation of voluntary guidelines for funding standards, benefit rules, etc., left uncovered by PEPPRA. This group could advise Congress when, if ever, further action may be necessary. To be truly independent, this Council should have its own executive director, staff, and budget, as well as a chairman with a term of office long enough to provide continuity.

Appendix:

California Assembly Bill 672: Relevant Excerpts

22218.6. The board shall submit an annual report to the Legislature, which report shall include:

(a) An outside audit of the system, including a cash flow analysis and a review of budget and staffing levels.

(b) A review by a consulting actuary, a summary of any changes in actuarial assumptions from the previous year, a review of the system's asset mix strategy, a market review of the economic and financial environment in which investments were made, and a summary of the system's general investment strategy.

(c) A description of the investments of the system, including the concentration of stocks and bonds, at cost and market value, including dividends and coupons, and a summary of major changes that occurred since the previous year.

(d) The following information regarding the rate of return of the system by asset type:

(1) Time-weighted return on a five-year, three-year, two-year, one-year, and six-month annualized basis.

(2) Dollar-weighted return on a five-year, three-year, two-year, one-year, and six-month annualized basis.

(3) Portfolio return comparisons which compare investment returns with an indexed bogey portfolio of legally acceptable equities, comparable funds, universes, and indexes.

(4) Returns as credited to employer accounts.

(5) Returns as reported in annual reports.

(6) Returns as reported by the Controller.

(e) A transaction summary which shall adequately review the system's custodial relationship and daily cash management, purchases, sales, turnover, private placements, soft dollar purchases, and transaction costs such as commissions, dealer spreads and accommodations.

(f) An explanation of the use by the system of outside investment advisers and managers and any participation in corporate annual meetings and shareholder voting.

(g) An outline of the basis of the employer contribution rate and the sensitivity of the rate and the funded status of the system to economic assumptions, actuarial methodology, decrement assumptions, and benefits and the reasons for any changes in the employer contribution rate from the previous year and projections of future employer contribution rates and funded status for the next 20 years, given various actuarial assumptions.

SEC. 10. Section 22218.7 is added to the Education Code, to read:

22218.7. The board shall submit a review of the system's assets to the Legislature on a quarterly basis which report shall:

(a) Discuss the system's portfolio and contain the following information:

(1) Concentration, current holdings at cost and market value, risk characteristics (R-squared, Beta, standard error), fundamentals (P/E, dividend yield, measures of growth, size, earnings quality, debt/equity) of equities.

(2) Concentration, current holdings at cost and market value, maturity, duration, quality, coupon, and current yield of fixed income instruments.

(3) Current holdings at cost and market value of real estate equities.

(4) Current holdings at cost and market value of mortgages.

(5) Securities lending activity.

(6) Options and forward commitments.

(7) Cash and cash equivalents.

(b) Disclose the following information on the rate of return of the fund by type of asset:

(1) Time-weighted return on a five-year, three-year, two-year, one-year, six-month and three-month annualized basis.

(2) Dollar-weighted return on a five-year, three-year, two-year, one-year, six-month and three-month annualized basis.

(3) Summary of performance of an indexed portfolio containing all legal investments and performance of comparable universes and other indexes.

(c) Include a performance review of asset allocation, of equities due to market timing, sector selection, stock selection and trading, of fixed income instruments due to interest rate anticipation skills, credit analysis, sector trading and swapping and of value added over indexing (alpha).

(d) A review of the system's custodial relationship and daily cash management and a summary of the system's investment transactions, including purchases, sales, turnover, private placements, soft dollar purchases, and transaction costs such as commissions, dealer spreads and accommodations.

(e) A review of the role of any outside managers and advisers, stockholder voting, and changes in investment staff or reorganization.

Footnotes

1. Technical Appendix, *Coming of Age: Toward a Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 587. See also, *Pension Task Force Report on Public Employee Retirement Systems*, House Committee on Education and Labor, as Cong. 2 sess. (GPO, March 15, 1978), p. 51.
2. *Task Force Report*, op. cit., p. 51.
3. Ibid., p. 53.
4. Data supplied by Howard Winklevoss & Associates to President's Commission on Pension Policy. See also, Preston, C. Bassett, "State and Local Pension Plans," in Technical Appendix, *Coming of Age: Toward a Retirement Income Policy*, President's Commission on Pension Policy, 1981, pp. 590-610.
5. *Task Force Report*, Table B5, pp. 56-57.
6. Ibid., p. 57.
7. Ibid., p. 62.
8. Ibid., p. 188.
9. Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management* (Twentieth Century Fund, 1976), pp. 9-10.
10. *Task Force Report*, p. 190.
11. See, Marcy Avrin, "Pension Fund Investment Decisions: Structural Reform," June 23, 1982; "Pension Fund Budget Decisions: Procedural Reform," September 13, 1982; "Investment Performance," November 30, 1982; all reports to the Joint Committee on Pension Fund Investment, Avrin Economics, Inc., 1982.
12. Avrin, "Pension Fund Investment Decisions," op. cit., p. 1.
13. See letter of Dan D. Lanoff to Louis Paper, Chairman, Joint Committee on Public Pension Fund Investments, June 17, 1983.
14. See letter of Governor Deukmejian to Louis Paper, July 28, 1983.
15. See statement of Francis R. Spaniola before the United States Senate Subcommittee on Savings, Pensions, and Investment Policy hearings on S. 2106, March 29, 1982, Washington, D.C.
16. Kohlmeier, op. cit., pp. 9-10.
17. *Task Force Report*, op. cit., p. 3.
18. John Peterson, "Public Pension System Financial Disclosure," Municipal Finance Officers Association, May, 1980, p. 3.

19. Ibid., p. 3.
20. See *Coming of Age: Toward a National Retirement Income Policy*, final report of the President's Commission on Pension Policy, February, 1981, p. 46.
21. Roy Schotland, Statement before the U.S. Senate Subcommittee on Savings, Pensions, and Investment Policy, hearings on S. 2106, March 29, 1982, Washington, D.C.
22. Schotland, op. cit., p. 9.

About the Author

Thomas C. Woodruff is the former Executive Director of the President's Commission on Pension Policy. Previously, he was Confidential Assistant to the Administrator, Pension and Welfare Benefit Programs, and Executive Assistant to the Assistant Secretary for Labor Management Relations, U.S. Department of Labor.

For the past two years, Dr. Woodruff has been an Associate Professor at the School of Industrial and Labor Relations, Cornell University. Currently, he is a consultant to a number of labor unions on collective bargaining and pension matters.

Mr. CLAY. Thank you.

Ms. Futrell, I know that many of your members have a problem in terms of their moving from community to community. It causes a problem with their pensions.

Do you have any suggestions as to how we could design a portability system?

Ms. FUTRELL. Well, we've been working on the concept of portability since about 1946 and have not found a solution yet. What we would like to do is to work with the Congress in coming up with a plan that would help our members.

You're absolutely correct. Within the education profession, we do have a lot of people moving around, and, as a result of moving, they oftentimes lose their retirement.

If we could find a way to build in portability, it would be very helpful to the members of the profession.

Mr. CLAY. Mr. Welsh, you were present and heard the testimony of Mr. Myers, who just preceded you. He advocates that we raise the age of retirement. What is your position in regard to that?

Mr. WELSH. Well, I think there are many other more immediate concerns, Mr. Chairman, but in fact I have no problem with that.

Mr. CLAY. You don't plan to retire early anyhow.

Mr. WELSH. I don't think, Mr. Chairman, any of us really ought to retire. I think we might change careers from time to time, but I'm not sure that retirement as such is a good idea.

Mr. CLAY. Unless we retire at the beginning of life.

Mr. WELSH. Well, that's right.

Mr. CLAY. Thank you.

Mr. Chandler.

Mr. CHANDLER. Well, I really have no questions. I thank you for your testimony, and I certainly want to say again that I am as interested this year in the PEPPRA bill as I was last.

I was wishing that Mr. Bartlett wouldn't come in, so we'd have a unified side over here on this issue, but I understand his concern, too, and it is a sensitive one.

You have the question of State and local government's jurisdiction. You know what the issues are. But I do plan to support it again, and I agree with you; I hope the subcommittee will take it up.

Thank you, Mr. Chairman.

Mr. CLAY. Mr. Kildee?

Mr. KILDEE. I have no questions. I just want to thank you for your testimony. It's very helpful to the committee to know the background of both your organizations, and they've been very helpful also.

Mr. CLAY. Mr. Bartlett.

Mr. BARTLETT. Thank you, Mr. Chairman.

I appreciate the witnesses' testimony, and of course we did have substantial hearings and markups on PEPPRA last year.

I suppose I'd have two questions.

First, in analyzing the need for Federal law with regard to public employees' pension reform, do you, Ms. Futrell or Mr. Myers, see improvements at the State and school district level with regard to public employees' pensions that have been made over the last 5 to 7 years, and how would you characterize those improvements?

Are things better than they were in 1978 or worse? About the same or substantially better? How would you characterize it?

Ms. FUTRELL. Well, what we've seen is a mixed situation. In some States, they have worked diligently to improve, to strengthen, the retirement plan for the public employees.

For instance, in Virginia we added the years of experience plus age as a requirement to retire. We put in provisions to protect funding, to make sure that that money was not tampered with by anyone. We put in provisions to make sure that the members receive information with reference to what the plan was all about, to explain what they needed to do in order to retire, and to raise the benefit level.

So in some instances we've seen improvements. In others, we've seen cutbacks.

I think that the most typical example that I could give is what was happening in Maryland last year, when there were efforts made to raid the retirement plan. Although the people banded together to try to protect the program, they ended up with some cuts.

So what we're finding across the country is a mixed situation. Some States are moving forward very progressively to try to strengthen their plans. Others are cutting back or making adjustments which we think are harmful to the employees.

Mr. BARTLETT. Well, let me see if I understand, because maybe we have a difference of opinion about what happens when you impose ERISA-like fiduciary standards.

It's my understanding that when you impose ERISA-like fiduciary standards, that you require the funds be actuarially sound and be guaranteed to be there when people retire. Sometimes that spells cutbacks. Sometimes that's the result; that's what it means.

So are you advocating that we adopt ERISA-like standards for the public employees?

Ms. FUTRELL. No. What we're saying is that whatever is put in and whatever is promised should be safeguarded. If I am promised that by the time I retire I shall receive a certain amount of benefits, then when I retire, that's what I should get. The people who are participating in the plans should not be penalized because the fiduciary projections were not accurate or there was not, for instance, level cost funding or something of that nature. Whatever we were promised when we made our contributions, when we get to the age of retirement, we should be able to get what we were told we were going to get.

Mr. BARTLETT. So if a fund is not actuarially sound, and if Congress were to, for example, adopt what many States have adopted, and that is disclosure or fiduciary standards to require that it become actuarially sound—I'm speaking in laymen's terms; there's more to it than that——

Ms. FUTRELL. Yes—that the funding be provided to bring it up to the level that——

Mr. BARTLETT. You used the word then "punished." I'm not sure I know about the "punished," but who would then provide that funding?

Ms. FUTRELL. I think that we would have to look to our State legislatures for the funding, and we did have that problem, by the way, in Virginia during the middle 1970's.

When we had the actuarial studies conducted, what we discovered was that funding had not been provided at the level to make sure that the people received the benefits they were promised. We had to say to the State legislature, "We were promised these benefits, and according to the actuarial studies, that's not what we're going to get, so we have to raise the funding to make sure that we get the benefits we were promised."

Now, in some instances, that means that those of us who are participating have to pay more, but it also means that the State might have to pay more. But we were able to deal with that in a satisfactory manner.

Mr. CHANDLER. Would the gentleman yield?

Mr. BARTLETT. I'd be happy to yield.

Mr. CHANDLER. I thank the gentleman for yielding.

It's been my observation that it probably works in the opposite direction, that some States and local governments were granting benefits beyond what was being funded with very little actuarial study to demonstrate that it was adequately funded. Then during the periods of economic decline, one of the first places that a legislature or city council or county government could go to reduce expenses without hurting anybody were those pension funds and just simply underfunding.

Ms. FUTRELL. Well, I don't disagree, and I think your observations are correct.

What we're trying to do now is to make sure that all the plans are being conducted in such a way that we have actuaries working with the pension people. We make sure that those who are sitting on the trust boards are much better educated about pension funds.

I think that as a result of some of the difficulties we encountered in the 1960's and the 1970's, we are doing a much better job of managing those funds and making sure that the benefits are there.

Mr. CHANDLER. Right; and with the PEPPRA standard, at least you'd know.

Ms. FUTRELL. Yes.

Mr. BARTLETT. Well, I thank the gentleman for his question.

I suppose that goes back to my original question. I diverted a bit, because I think you are correct, and it's important that we recognize that when we adopt disclosure and ERISA-like standards and sound actuarial accounting, that the result of that, as the gentleman from Washington said, is usually that either benefits are reduced or payments into the fund are increased.

The adoption of strict actuarial standards usually does not mean that we find that there is a surplus. Now, there have been exceptions, but usually then, when we find out the problems, then there's going to be some pain involved. So I think the cutback argument really works exactly in the reverse.

Your last statement then was that you think that—and I'm trying to recall it—that you think that generally things have improved from the 1970's?

Ms. FUTRELL. What I'm saying is that things have improved to some degree, but it's really a mixed bag. In some areas, things have not improved. In some areas, the funds have been cut back; the programs have been weakened. We have tried to oppose those kinds of efforts.

I think that as far as actuarial soundness, we are using professional actuaries more so now than we did before.

Mr. BARTLETT. Can you cite, either now or for the record, any States in which there continues to be a problem with actuarial soundness or disclosure?

Ms. FUTRELL. What we will do is get that information for you. We have a very strong program dealing with retirement and dealing with pension plans.

Mr. BARTLETT. I would very much like to have them. I do think that they no doubt do exist. I wonder if you can give us some examples.

Ms. FUTRELL. We'll have that for you.

Mr. BARTLETT. It's two questions. One is on fiduciary standards—your actuarial soundness—and the other one is on disclosure to the beneficiaries.

Mr. BARTLETT. Mr. Myers, do you have something to add then to that?

Mr. WELSH. Mr. Bartlett, what I think is important from AFSCME's standpoint is slightly different from that of the teacher plans. We find that the lack of information on many of the smaller governments plans is where most of our problems arise.

Most teacher plans, I think I'm accurate in saying, are usually State-wide plans. Our problems can occur with State-wide plans for State employees, but also we have very little knowledge about a great many local and smaller plans. Just getting basic disclosure and reporting on those plans would be extraordinarily helpful to any of us who are looking at an income policy.

I'd also point out to you—that there remains in this country a substantial number of State and local employees who are not covered by Social Security. These employees rely exclusively on their pension plans for their retirement which underscores the need for certain Federal retirement income protection.

Mr. BARTLETT. Mr. Chairman, I know my time has almost expired, but I have a very quick follow-up question to clarify on the record, because I think I heard you say you see a distinction between—I'll just ask.

Do you then see a distinction between the need for disclosure and the need for ERISA-like fiduciary standards set by national policy? Then, from the tone of your statement, it sounded as if you see disclosure as much more important, not to minimize your position——

Mr. WELSH. Well, we support both. If you want to look at it, I think once you have effective reporting in disclosure, then the Congress and the committee will see the need for fiduciary standards. In other words, it's often hard to make the case without the facts, but I think they both flow together. We attached to our testimony the earlier study conducted by Mr. Woodruff that lays out that case, and I commend it to you. I'm sure you're aware of it from last year's hearings.

Mr. BARTLETT. Thank you, Mr. Chairman.

Mr. KILDEE [acting chairman]. I would observe that the fiduciary standards in the bill require prudent investment of the money in the fund, but it does not require the actual funding, say, by the governmental body there. That's a distinction I think we have to bear in mind there.

So the goal of the bill would be actuarial soundness, but actually the bill does not really require that. I think we want to make clear that distinction in the bill in our discussion.

Mr. Hayes.

Mr. HAYES. Thank you, Mr. Chairman.

Ms. Futrell, a portion of your statement which you underline I think is worth reading, because it gives rise to a couple of questions, I think, that I would like some reaction to from you and Mr. Welsh, because I think it spills over not only in the public sector but in the private sector to some extent and relates to the whole problem of security.

> Programs aimed at providing security and dignity to our elderly must not and cannot be exploited as political footballs to be tossed about in the game of budget-balancing or deficit-slashing, but should be viewed as intrinsically vital to a strong and secure nation.

Now, my two questions that I would like to raise, one has to do with what appears to be a growing pressure to replace full-time employees with temporary employees, particularly in the public sector, beyond just a windstorm that appears to be reaching tornadic proportions, and the other thing is the pressures to reduce the Federal minimum wage as it affects particularly the private sector.

These, I think, are some of the two things that are going to affect the security of our people as they proceed toward retirement, and, not only that, I think it does affect the security of the health and growth of our Nation.

This seems to be the two directions that this administration seems to be going, and I think they're more than just political footballs. I think they're serious in pushing these two kinds of issues as they try to find ways and means to reduce the deficit, and I'd just like your reaction.

Ms. FUTRELL. Well, first of all, we are finding that within the teacher profession, the use of part-time employees is spreading. We have two concerns—No. 1, that the children deserve full-time teachers, people who are going to be there all day, all week, all month; but we also have a concern that in many instances the part-time employees are not given any benefits. They are given a reduced wage, and they have to purchase their benefits, if they want them, out of that salary.

So here we have people who are being used to take the place of full-time employees, and they're not being given benefits which would help them.

As far as the reduced minimum wage is concerned, I think that the concerns we would have would be the effects of the cost of protection. Pension plans are very expensive, and with a reduced minimum wage, young people perhaps will not have the opportunity to purchase those protections. And, as they grow older, they will lose as a result of having that lower wage in the beginning.

Mr. WELSH. I think, Mr. Hayes, the thing that frightens us most is this proposal for a youth subminimum that is floating around. Frankly, I think that you will find major problems as the county and city Federal aid is cut back—revenue sharing and the other various program cuts the administration has proposed. The question of how do you clean up the parks and how do you do various services in those municipal and county governments is going to be faced by the mayor or the county commissioners who may say, "Well, we can hire this group of young people in the summer for $2.50 an hour and pay them no benefits." It's a powerful incentive for substituting that work force for the regular work force. We've had this problem, as you well know, with the CETA program and others, where we've had this tremendous substitution problem. It's a terribly complicated issue in terms of dealing with the unemployment of youth in our cities.

But to further aggravate it by this dual attack of cutting back on Federal monies at the same time enacting a subminimum wage, is the worst of all public policies. I think it's going to impact on the public sector in many ways even more than it will impact on the private sector.

Mr. HAYES. Thank you, Mr. Chairman.

Mr. KILDEE. Mr. Owens?

Mr. OWENS. Yes; my question is closely related to Mr. Hayes' question.

Both of you have broad humanitarian concerns beyond your own membership, and given two definite trends—one is the question I asked before of previous witnesses about the entrepreneurship trend, where there'll be smaller and smaller employers, so that more and more people will not be covered just because their small employees won't be pushed by unionization, really, to make them cover.

Also, the other trend is this political football you talk about that, once government begins to play with fringe benefits and retirement plans in terms of taxation, both employers and even employees will back away from accepting whether they want to substitute in some cases the higher wages for the fringe benefits.

So the likelihood is that more and more people, as we go along, are going to end up with Social Security being their only retirement plan.

In light of that, what comments would you make on Social Security policies, the way they should be shaped? I don't think the last word has been said about Social Security, and I would just like you to take a minute to comment.

Mr. WELSH. Well, I would simply say, first, we're opposed to this business of playing around with the COLA. I think that's breaking, in effect, the contract with the present recipients. It's likely to further undermine confidence in the system. So that's one thing that I would point out.

You are absolutely right in terms of the pressure on the Social Security system that occurs if you begin to tax these benefits. You are setting up a dynamic in which the young worker says to his person at the bargaining table, "I'll take it in wages; I don't want it in health plans; I don't want it in a pension plan; give it to me in wages now."

All you have to do to illustrate this is to look at the Federal employee health system where you have a very broad range of choices of health plans, some of which pay lower benefit levels, some of which pay higher benefit levels.

The single Federal employee who looks at his option and says, "I should take the cheapest plan I can get, because I'm going to gamble that I won't be sick," picks a low cost option simply because it will not immediately come out of his paycheck. That's what is going to happen the minute you start taxing in this area. It is going to place the person at the bargaining table in a difficult dilemma. It's going to have an enormous impact on the health care services. Now, a lot of things need to be done in the health care area, but you don't need to add this problem. It affects longer-term ability to access good health care, and that will have impact later in life and on the Medicare system—all of those things are tied together—as will the willingness to take cuts in the private area. The public pension plan, in exchange for cash now, will have much more pressure on the Social Security system.

Those are the things that we think are right on the edge of Congress changing policy through its tax policy that would have enormous long-range impacts and have to be stopped before they go any further. No matter what you do to the overall rates, it's much more profound than that.

Ms. FUTRELL. I would agree with what he has said. More and more of the businesses which are being started are small, because that's generally how people get started—they have to get their toe in the door first. I don't think that that should be an excuse, whether it's a small business or a large business or public or private, to propose that we tax benefits. It simply is not fair to say to individuals, "You should pay for the fringe benefits you receive," because basically what you're doing is lowering the wages that the individuals actually take home.

As far as the Social Security is concerned, within my statement which was submitted for the record, on page 4 we talk about the whole issue of Social Security, and we're very pleased to have had the opportunity to work with Congress in stabilizing the Social Security Program during the earlier part of, 1983. As a result we now have a much more solvent plan than we thought we would ever have.

If we continue along the track that we have established, we should be able to maintain the solvency of that program, at least through the year 2030, which, by the way, will be beyond the time when I will probably be here, but I feel good about the fact that it is solvent.

We have asked in our testimony that this committee avoid the COLA freezes, because we believe that that would have a negative impact on the people who have received benefits under Social Security and for those who would receive them in the future.

We also raise concerns with reference to the equity issue as it relates to women. We are especially concerned with those women who work in the home—women who are told that, "While you make a major contribution to your family and to society, you will not be able to participate under this program because you are not salaried."

We have some real problems with that. We believe that we need to look at how can we help women who work in the home—that their contribution to the family be counted toward Social Security so that their benefits will not drop very drastically.

I must relate to you a personal experience. We just had a death in my family, and the reality of all this comes home. My mother found out that after my stepfather died, her income had been cut by more than half. All of a sudden here she is, at an age when she should be thinking about enjoying her years of retirement, simply wondering how she's going to survive.

That, to a large degree, is due to the low income that she received for so many years and because the benefits for women are not as high as they are for the men.

Mr. **Owens**. Thank you. I have no further questions.

Mr. **Kildee**. I want to thank the panel for their testimony today, and we'll let you go at this time. Thank you very much.

Ms. **Futrell**. Thank you.

Mr. **Welsh**. Thank you.

Mr. **Kildee** [presiding]. The next panel will consist of Karen Ferguson, director of the pension rights center, accompanied by Karen Friedman of the women's pension project, and Jack Guildroy, a member of the national legislative council of the American Association of Retired Persons, if they would come forward.

I see Karen Friedman is here.

Do you want to start the testimony then?

Ms. **Friedman**. Sure.

STATEMENTS OF KAREN FRIEDMAN, WOMEN'S PENSION PROJECT; JACK GUILDROY, MEMBER, NATIONAL LEGISLATIVE COUNCIL, AMERICAN ASSOCIATION OF RETIRED PERSONS; AND KAREN FERGUSON, DIRECTOR, PENSION RIGHTS CENTER

Ms. **Friedman**. My name is Karen Friedman, and today I'm representing the women's pension project and other members of the coalition for pension equity, including the Women's Equity Action League, BPW-USA, the National Federation of Business and Professional Women's Clubs, and the National Organization for Women.

Each of these groups supports a fair pension system that reflects the work patterns and lifestyles of women today.

First, we want to take this opportunity to thank the members of the subcommittee for the crucial role they played in passing the Retirement Equity Act last session. The early survivors' provisions and the consent provision of the Retirement Equity Act were desperately needed and will help hundreds of thousands of women.

We certainly appreciate your leadership role in last year's fight for the Retirement Equity Act, and we're grateful for your commitment to further reform the pension system.

Many people believe that the passage of the Retirement Equity Act addressed all the problems that women faced in the pension system. Although the Retirement Equity Act was important, it was only a first step.

For most women, getting pensions is still a matter of luck. The first step toward getting a pension is to work for a company that has a pension plan. Unfortunately, many of the jobs women are likely to have in the retail and service industries do not even offer pensions.

For Alice Chamberlain of New York, having a pension plan in her company wasn't enough. She discovered the hard way that employers aren't required to include all their employees in plans. In her case, the plan included everyone except secretaries. It just so happened, she was the only woman and the only secretary.

Pension plans should not be allowed to exclude anyone from coverage. Too often, those who are left out are women.

Plans are allowed to also exclude employees who start within 5 years of the plan's normal retirement age. This means that most people hired after 60 can be left out. It's legal age discrimination built right into the system.

Congress must act to remove the barriers preventing older people from participating in pension plans.

Barbara Lyons of Louisville, OH, found out that she was left out of her plan for yet another reason. She discovered, too late, that employers can require employees to work at least 1,000 hours a year in order to become plan members. Even though she had 12½ years, she didn't have the hours.

With 11 million part-timers in the work force, we need extra protections. Congress should discourage the exclusion of part-timers by requiring prorated benefits for employees who regularly work at least 500 hours.

Even if a woman is included in the plan, she still needs to work long enough to earn the right to a pension. Almost all workers in medium and large company plans must work 10 years in order to vest. We recently heard about a woman, a bank teller in Chicago, who lost out by just 8 hours.

Most women will not even come close to working 10 years. The median job tenure for women is 3.7 years. We believe that vesting should be reduced to 5 years now, phasing in a 3-year vesting requirement over a period of time.

For those women who are receiving pensions, the amount is still inadequate. The low wages paid to women throughout their careers translate into low pensions upon retirement.

Because women tend to dominate the lower-paid positions in the workforce, pension integration formulas—that is, those which use Social Security to reduce the pensions of shorter service, lower wage earners—hit women harder than men.

In Betty Smith's case, her plan's pension integration formula, which subtracted half of her Social Security, actually wiped out her pension completely.

Mr. Chairman, if there are no objections, I would like to submit for the record a copy of "The Case of the Disappearing Pension," which is a pension rights center publication that describes in detail how pension integration affects women.

Mr. KILDEE. Without objection, it will be included in the record.

[The booklet follows:]

THE
CASE
OF THE
DISAPPEARING

PENSION INTEGRATION

"It just vanished into thin air!"

Susan Griffiths had worked for 14 years under her company's pension plan—more than enough to earn the right to a pension. But when she retired, she discovered that her pension had disappeared.

The letter from her company said: "There is no benefit payable to you from the pension plan because the social security retirement benefit, as estimated under the plan formula, is sufficient to meet the plan's income goal."

"What does this mean?" Ms. Griffiths wondered. She reread the letter searching for a clue. She read the booklet summarizing the pension plan that her company had given her. She thought there must be something in the letter or the booklet that could help her solve the mystery.

In fact, the clues were in her plan booklet but it took a lot of detective work by Ms. Griffiths before she found them and understood what they meant. That was when she learned about pension INTEGRATION!

What that word meant to Susan Griffiths was that after having done everything necessary to earn the right to a pension, she would receive nothing from the plan.

What is integration?

Susan Griffiths lost her pension because her company "integrated" social security with her pension benefit—subtracting part of her social security benefit from her pension benefit.

Integration is a method companies use to take social security benefits into account when calculating what an employee will receive from the company pension plan. It permits companies to direct pension benefits toward higher paid employees in order to counter the "tilt" in social security toward lower paid employees. The result is a smaller pension or sometimes none at all for the lower paid.

Most people who work for small companies and almost half of the employees of large organizations are under integrated plans. You're least likely to be affected by this practice if your pension plan was negotiated by a major union.

Why you need to know about integration

Unless you understand about integration, you may be planning your retirement on a mistaken notion of how much money you will have.

If you are like most people who have a pension plan where they work, you assume that if you work long enough to meet the plan's conditions for a pension, you will get your full benefit. But if your plan is integrated, you could lose a portion of your benefit or be left only with social security, as happened to Susan Griffiths.

Since social security was never meant to provide you with all the income you need in retirement—payments to people retiring now average only about $5,000 a year—a pension is likely to make a critical difference to your retirement. Only by learning about integration will you know what really to expect from your pension plan.

In this pamphlet, we'll help you learn how to decipher the language of your pension plan booklet to discover whether integration is part of your plan and, if so, how it affects your pension benefit. We will also discuss the arguments for and against integration and tell you how you can take part in the debate about this issue.

Is your plan integrated?

The word "integration" is seldom found in the booklet companies give employees about their retirement plan. But if your plan booklet does not talk about integration specifically, see if it mentions social security at all. It might say something about your pension being "offset" by social security, for instance. Or it might mention that the formula for benefits applies only to salary above a certain level.

Look for clues to whether the plan is integrated particularly in the section of your booklet describing how your retirement income is figured. One plan says, for instance, "Your projected Primary Social Security benefit amount is used in calculating your retirement benefit because (the company) has been paying Social Security taxes on your earnings throughout your working years with [the company]." Another plan says very directly: "This formula is coordinated with Social Security." And one plan describes the method it uses in these terms:

> That portion of the Average Annual Compensation up to the Social Security Integration Level is multiplied by a factor of 1.15% times the number of years of Accredited Service. The portion of the Average Annual Compensation which is in excess of the Social Security Integration Level is multiplied by a factor of 1.40% times the number of years of Accredited Service.

But if there is nothing in your plan booklet which gives you a clue to whether the plan is integrated or not, ask for the legal pension plan document. If you have trouble understanding the legal document, ask your personnel manager or plan administrator whether the plan is integrated.

You have the right to write your plan administrator asking for a statement telling you whether you have earned the right to receive a pension and how much your benefit would be at retirement if you left the company today. Ask to be shown what formula is being used to determine your benefit. Be sure to ask how much you can expect to receive over and above social security.

How integration works

If your plan is integrated, there are different ways in which the process can work. How much of your pension you might lose will depend on the formula used.

Offset Method — Typically in a pension plan which uses the offset method, the employer deducts 50% of the social security benefit from the pension amount. The law allows the employer to deduct as much as 83⅓%, but most employers subtract less. (The offset method was used at the company where Susan Griffiths worked.)

Let's see what a 50% reduction would mean to you if you were earning $15,000 a year or $1,250 monthly at retirement. Let's also assume that you worked for this company for 10 years and are now about to retire at age 65.

We'll assume that your company bases your benefit on 1.5% of the highest five years of average monthly earnings times years of service—a formula used by many companies—and that your average monthly earnings over the last five years have been the $1,250 you are now earning.

The formula would result in a lifetime monthly pension benefit of $187.50 (1.5% x $1,250 x 10). Your social security benefit probably would be about $544 but remember, your company subtracts 50% of that amount from your pension benefit. That means $272 would be subtracted from $187.50. Obviously, that leaves you nothing from the pension plan.

Even if you are earning $25,000 a year ($2,083 monthly) at this company, you would not receive anything from the pension plan because half of your social security benefit of $700 would be $350 and that would be greater than the $312 from the pension plan.

In both cases, you would still be getting your social security benefit even though there was nothing coming from the pension plan.

Excess Method — Under the excess method, your employer would give pension credit only for earnings above a certain level.

Let's use as an example a defined benefit plan (which was the type we used in the offset example) which provides a yearly pension equal to 1% of final average earnings above $13,000 multiplied by years in the plan. You are retiring this year at age 65. If your final average earnings were $15,000 a year and you had 10 years of service, the formula would be: $2,000 ($15,000 – $13,000) x 1% x 10 or $200 a year ($16.67 a month). That amount would be added to your social security benefit.

Step-Rate Method — Your plan might provide some kind of benefit for earnings below a certain level and higher benefits for earnings above that level. That makes it a "step-rate" plan.

Again, let's use $15,000 as final average salary and 10 years in the pension plan. This time your plan has a step-rate formula which pays 1% on the first $13,000 of final average earnings plus 2% of earnings over $13,000. Years of service are also taken into account in this formula.

First we have to separate your salary into the first $13,000 on which the 1% will be paid. The formula of 1% x $13,000 x 10 equals $1,300. The other $2,000 of your salary will be multiplied by 2% and 10 years to equal $400. The combination of the two would be $1,700 a year or $141.67 a month—again to be added to your social security benefit.

Note: These examples are meant to show how different integration methods work. If you work for a long time, say 30 years, under one plan your pension benefits will be larger.

There are some other things about integration you need to know.

One is that if you have worked for several different employers, all of whom have integrated plans that use the offset method, each employer is allowed to take into account the social security benefits you have earned up to the time the employer hired you, as well as the social security earned at that job. This means that even if your social security benefits are based on contributions from several employers, your last employer can take your entire social security benefit into account in calculating your pension. Employers are, of course, not required to do this and many do not.

Another thing you need to be aware of: it is perfectly legal for a plan to integrate your pension based on assumptions of what your social security would be if you stayed in the workforce most of your life. In many cases these estimates may be higher than your actual earnings under social security. This is especially true of women who leave the workforce temporarily to raise children. If you find that your plan used incorrect assumptions and subtracted too much social security from your pension, you have the right to bring in your social security records and have the plan readjust your pension so it reflects your actual social security benefits.

As of 1984, defined benefit plans that are integrated on an offset basis must notify you in writing of your right to supply actual salary history and must adjust your benefit if you do supply that history. That notification must be given to you each time you are given a summary of your plan and when you leave your employer. The notice should tell you that you can obtain your actual salary history from the Social Security Administration and give you a reasonable period of time to provide the history.

Why plans are integrated

If you've now discovered that your plan is integrated, you may still be wondering about a practice that makes pension benefits vanish. Why are employers allowed to integrate their plans? Let's assume Susan Griffiths learned before she retired that she would be "integrated out" of her pension and went to talk to her boss, Tim Chesterton.

Susan Griffiths: Mr. Chesterton, I just got a letter from you telling me that because of my social security I'm not going to get any money from the pension plan when I retire. What does social security have to do with the pension I earned here at Crescent Corporation?

Tim Chesterton: Our pension plan is coordinated with social security, Ms. Griffiths. That means the pension plan takes into account the social security taxes we paid on your behalf. You paid half of your social security and we paid the other half.

Susan Griffiths: But the law requires you to contribute to my social security. Why should you get credit for paying a tax?

Tim Chesterton: Let me try to explain another way, Ms. Griffiths. The goal of the company pension plan is to assure that total retirement income (pension benefit plus social security benefit) replaces about the same percentage of working pay for all employees at all levels of income so that everybody will be able to maintain their standard of living in retirement. For example, your supervisor, Ray Farnsworth, makes $45,000. What he will receive from social security will replace only about 19 percent of his salary. Your social security, on the other hand, will probably replace about 44 percent of your salary. So we feel we should direct greater pension benefits to Mr. Farnsworth so that the combination of his pension money and social security benefits will bring him closer to a replacement of his former salary—as close as you are to yours, for instance.

Susan Griffiths: But I can't live on 44 percent of my salary. I know my taxes will be a little less and some of my expenses may go down a bit, but I've needed every cent of my paycheck to keep my head above water. How am I supposed to survive on less than half of what I'm getting now? Mr. Farnsworth has a savings account and some stocks and bonds. And he owns his house which is practically paid off while I pay rent. All I'll have to live on in retirement is social security. He'll have the Crescent pension, savings, stocks and bonds, house and social security.

Tim Chesterton: We weren't thinking only of employees like Mr. Farnsworth when we drew up the pension plan, Ms. Griffiths. There are people at Crescent like Steve Duke, the maintenance clerk, who could actually get more than 100 percent of his salary in retirement from both social security and our pension plan if we didn't integrate the plan with social security. He makes less than you do and he's married, so his social security benefit will replace almost all of his salary. Add the company pension without integration and he'd go over 100 percent!

Susan Griffiths: He'd get that large a pension only if he works here more than 30 years and you know he's been here only 12 years. Very few, if any, Crescent employees put in 30 years. Also, if Mr. Duke's wife dies, the social security will be a lot less. And what about inflation? Maybe he should start out retirement with a little more than he was earning. After all, his pension is going to be fixed at the same amount for his entire lifetime, no matter how much the cost of living goes up. Besides, if that's what you're worried about, why not just set a ceiling of 100 percent? That would certainly be easy enough to do.

Tim Chesterton: We think integration is a perfectly reasonable approach, Ms. Griffiths. But even if you don't accept the other arguments I've offered, you have to realize that the Crescent Corporation has to be very concerned about costs.

Susan Griffiths: But don't you get a tax break for the money you put into the pension plan? And isn't my salary lower than it would have been if Crescent weren't paying into a pension plan?

Tim Chesterton: If we didn't integrate our pension plan, we would have to pay more in benefits to our employees. Then we might not be able to afford benefits for anybody. There would be no pension plan.

Susan Griffiths: You don't have a plan now, Mr. Chesterton, as far as I'm concerned.

I'm not going to get a pension and neither are a lot of other people at Crescent.

You may not lose your entire pension, as Susan Griffiths did. However, her situation is based on that of a real person. Her imaginary conversation with her boss should help you understand the arguments for and against integration.

What you can do

Now you've solved the integration mystery. You know whether your plan is integrated and why. If you've discovered that your pension will be reduced or eliminated by integration, what can you do?

You and your co-workers can share your concern with top management in your company.

Here's what Lee Miller of Baltimore, Maryland did. Mr. Miller had worked for Baltimore Gas and Electric for 32 years. When he retired, he learned that he was losing $1,000 a year from his pension benefit because the company plan was integrated.

To Mr. Miller, a pension was part of a worker's wage which his company had no right to take away. He got in touch with co-workers, newspaper reporters and his Congressman. His campaign at Baltimore Gas paid off. The company eliminated the social security offset.

According to company officials, it was the "unrelieved complaining" of the employees that convinced them to drop integration. "There are certain battles you simply can't win," a company official said.

You can get in touch with organizations concerned about issues affecting workers and retirees.

That is what Betty Thomas of Austin, Minnesota did.

When she left her job as a clerk with a Minnesota food chain after ten years, she was earning between $8,000 and $9,000. Despite meeting all the requirements for vesting under the company's pension plan, she learned that she would get nothing from the plan at retirement. The company used the offset method of integration, deducting 50% of her social security benefit from her pension benefit.

Betty Thomas took the matter to the Minnesota AFL-CIO which, at its state convention in September, 1979, passed a resolution opposing integration. Her action brought her to the attention of the U.S. Department of Labor which invited her to talk about integration on a television program aired throughout the country. Although this did not restore Ms. Thomas' pension benefit, it did draw public attention to her situation and the practice of integration.

You can let your Representative and Senators in Congress know what your situation is and how you feel about it.

That is what Susan Griffiths is planning to do.

Members of Congress have been concerned about integration for many years. In 1974, a freeze on integration was passed by both the House of Representatives and the Senate as part of major private pension reform legislation but was deleted at the last moment from the final law. An attempt to limit integration was made in 1978, but strong pressure from employer advocates defeated the move. In 1982, as part of the Tax Equity and Fiscal Responsibility Act, Congress prohibited certain small plans from completely "integrating out" pension benefits by mandating that these plans provide at least a minimum benefit.

Recently, there has been renewed interest in integration because of concern about federal deficits. The revenue loss from tax breaks for pension plans was estimated at $30 billion for 1984—the largest of all federal tax expenditures.

Opponents of integration are saying that the only justification for the taxpayers to bear this expense is that lower paid workers need a pension in addition to social security. Supporters of integration are taking the position that pension plans are voluntary and companies will continue them only if they are allowed to use plans to reward higher paid employees.

What do you think?

Up until now, public attention has been rare for integration. That is changing. Now that integration concepts and formulas are no longer a mystery, you too can join in the public debate about this important issue.

Ms. Friedman. Women who enter the work force late in life or stay on the job because they need additional income may find that plans do not have to give additional credit toward the amount of a worker's pension once she reaches age 65. This means anyone who works past age 65 may find her benefit frozen at that point. This is very unfair.

Inflation is another problem that hits everyone but has an especially devastating impact on retirees. A retiree entitled to a pension will probably receive the same amount for the rest of her life. Every year we hear from retiree after retiree who are still living on the same $65 or $75 they were making a decade ago. It's unrealistic to expect retirees to live on yesterday's pensions with today's prices.

We understand that the problem of mandating automatic cost-of-living increases is complex. However, in cases of well-funded or overfunded plans, which seem to be the rage today, such an arrangement is definitely feasible. We propose that Congress begin exploring cost-of-living increases in these situations.

Portability of pensions would also help address the cost-of-living issue for mobile workers by allowing workers to roll over their vested pensions into interest-bearing accounts, ensuring that many more future retirees will have adequate retirement income.

We're delighted that the subcommittee has sponsored this series of hearings to address the need for a coherent national retirement income policy.

Certainly the Retirement Equity Act and TEFRA—the Tax Equity and Fiscal Responsibility Act—of 1982 were important first steps toward improvements in pensions for women.

We now look forward to working with the subcommittee to make even greater strides toward an equitable system that takes into account the time women spend in the work force.

We hope Congress acts swiftly to remove the remaining inequities that prevent our retired workers from receiving the adequate retirement income they need to enjoy their later years with dignity.

Thank you for the opportunity to present our views today.

[Prepared statement of Karen Friedman follows:]

PREPARED STATEMENT OF KAREN FRIEDMAN, WOMEN'S PENSION PROJECT

Mr. Chairman and Members of the Subcommittee, my name is Karen Friedman and I welcome this opportunity to testify today. I am representing the Women's Pension Project and other members of the Coalition for Pension Equity including the Women's Equity Action League and BPW-USA, the National Federation of Business and Professional Women's Clubs. Each of these groups supports a fair pension system that accurately reflects the work patterns and lifestyles of women today.

We want to take this opportunity to thank the Members of this Subcommittee for the role they played in passing the Retirement Equity Act last session. The early surviviors' provisions and the consent provision of the Retirement Equity Act were sorely needed and will help hundreds of thousands of women. These provisions are firm recognition that a pension is indeed earned by both partners in a marriage. Chairman Clay, your leadership in last year's fight for the Retirement Equity Act was very much appreciated and we are grateful for your commitment to further modify our pension system to make it more equitable.

Many people believe that the passage of the Retirement Equity Act addressed all of the problems women faced in receiving pensions. Although the Retirement Equity Act was important, it was only a first step. For most women, getting pensions is still all too often a matter of luck. The first step toward obtaining a pension is to work for a company that has a pension plan, Unfortunately, many of the jobs women are likely to have do not offer pensions. It is worth noting that the manufacturing field, which is heavily dominated by men, covers 66% of its employees; yet the female-dominated retail and service industries cover only 33% of its employees in a pension plan.

For Alice Chamberlain [1] of New York, having a pension plan in the small manufacturing firm where she was employed was not enough. She discovered the hard way that employers are not required to include all their employees in pension plans. In her case, the plan included everyone "except anyone employed as a secretary." It just so happened that Alice Chamberlain, who had worked for the company for 13 years, was the only woman and the only secretary. This is an outrage. Pension plans should not be allowed to exclude anyone from coverage. Too often those left out are women.

Presently plans are allowed to also exclude employees because they are "too old" when they start working for a particular company. ERISA says that plans are not required to cover anyone who starts within five years of the plan's normal retirement age. This means that most people hired after 60, many of whom are being forced to look for new employment to make ends meet, may be excluded from coverage. This type of exception is legal age discrimination built right into the system. The REA addressed the problem of employees who were excluded from plans because they were too young. Congress must act to remove the barriers preventing older people from participating in pension plans.

Barbara Lyons of Louisville, Ohio, found out that she was left out of her plan for another reason. She had worked for her company 12½ years on a part-time basis; she discovered—too late—that employers can require employees to work at least 1,000 hours a year (about 20 hours a week) in order to become plan members. We have been told that there are situations, particularly in retailing, where employers deliberately limit part-timers to 19 hours a week to keep their employees just under the 1,000-hour-a-year ERISA protections. To work toward a fairer retirement income system that pays out to as many workers as possible, Congress should discourage the exclusion of part-timers by requiring prorated benefits for employees who regularly work 500 hours or more a year.

Even if a woman is included in a plan, she still needs to work long enough to earn the right to receive a pension. Almost 9 out of 10 workers in medium and large company plans must work 10 years in order to "vest." Millions of women each year miss the 10-year mark and thus will not get a pension. We've heard of cases as extreme as that of Mary O'Brien, a bank teller in Chicago, who lost out by 8 hours. But most women will not come close to working 10 years. The median job tenure for women is 3.7 years. We believe that vesting should be reduced to 5 years now, phasing in a 3-year vesting requirement over a period of time.

For those women receiving pensions, however, the amount is still inadequate. The low wages paid to women throughout their careers translate into low pensions upon retirement. The most common formula for calculating pension benefits multiplies a percentage of a worker's average earnings by the number of years she was covered by the plan. Since women are paid about 60% of what men are paid, their pensions reflect this smaller sum as well. This is another instance where the pay inequities experienced by women workers continue to penalize them in their later years.

The pension integration formulas that use social security to reduce the pension of shorter service, lower-wage earners are another way in which women workers are hit harder than men, because women tend to dominate the lower-paid positions in the work force. Integration allows employers to subtract part of an employee's social security benefit from her pension. [Mr. Chairman, if there are no objections, I would like to submit for the record a copy of The Case of the Disappearing Pension, a Pension Rights Center publication that describes in simple language how integration works and the arguments for and against this practice.] Pension integration is unfair and takes away benefits from lower-paid workers who need pensions most.

Let me give you an example. Betty Smith of Austin, Minnesota, thought she had earned the right to a pension worth $77 a month. But when her pension plan subtracted 50% of her social security from her pension ($99), she was left with a vested pension worth zero. Hers is a compelling case of why integration should be eliminated.

---

[1] Not her real name. The names of the women used in this testimony have been changed at their request to protect their jobs or to ensure that litigation in which they're involved is not jeopardized.

Another method used to calculate pension benefits, giving more weight to the later years of work, also places women workers at a disadvantage. Backloading, as this method is called, benefits employees who stay with the company the longest. Congress should closely examine this method and its impact on women, who tend to have different work patterns than men.

There are a number of reasons why the current pension system does not accurately reflect women's work patterns. Many women enter the work force late in life either because they are widowed and receive inadequate retirement income based on their spouse's pension or because social security does not provide them with a sufficient income. Presently plans do not have to give additional credit toward the amount of a worker's pension once she reaches age 65. Although the federal Age Discrimination in Employment Act is designed to protect workers up to age 70, the law has a special exception for employee benefit plans. This means anyone who works past age 65 may find her benefit frozen at that point.

Inflation is a problem that hits everyone, but has an especially devastating impact on retirees. A retiree entitled to a pension will probably receive the same amount for the rest of her life. Every year we hear from the same retirees teling us that they're still getting $65 or $75 a month—the same they were receiving a decade ago. It is unrealistic to expect retirees to live on yesterday's pensions with today's prices.

We understand that the problem of mandating automatic cost-of-living increases is a complex one. However, in cases of well-funded or overfunded plans, such an arrangement is definitely feasible. We propose that Congress begin exploring cost-of-living increases in these situations. Also, portability of pensions would help address the cost-of-living issue for mobile workers. By allowing workers to roll over their vested pensions into interest-bearing accounts, we are ensuring that many more future retirees will have adequate retirement income.

Ensuring a decent retirement for men and women is precisely why we have a pension system so heavily encouraged by tax policy. It is the logical source to supplement inadequate social security benefits.

The reason that many employers set up pension plans is that they represent a substantial tax shelter. Contributions to a qualified pension plan are tax deductible and income earned by the fund is not taxable to the plan. Since huge tax breaks are given to these plans, we think it is entirely reasonable to insist that older women workers have a fair chance of receiving an adequate pension at retirement. Because even if a woman doesn't get a pension, she is paying for others who do. As a worker, she is receiving lower wages in exchange for employer contributions to a pension fund, whether or not she has any hope of ever collecting a pension. As a taxpayer, she, along with other Americans, pays billions of dollars more in taxes to make up for tax breaks enjoyed by private pension plans.

We are delighted that the Subcommittee has sponsored this series of hearings to address the need for a coherent national retirement income policy. Certainly, the Retirement Equity Act and TEFRA, the Tax Equity and Fiscal Responsibility Act of 1982, were important first steps toward improvements in pensions for women. Through TEFRA, Congress recognized that "non-key" employees—that is, mostly women—need pensions, too, and enacted more reasonable vesting and benefit rules for "top-heavy" plans. We've heard case after case of women who have benefited from TEFRA. The Retirement Equity Act made important steps toward reforming other plans.

We are looking forward to making greater strides, with the Subcommittee's help, toward an equitable system that accurately reflects the time women spend in the work force. We hope that Congress will act swiftly to remove the remaining inequities that prevent our retired workers from receiving the adequate retirement income they need to enjoy their later years in dignity.

Thank you for the opportunity to present our views.

Mr. **KILDEE**. Thank you very much.

Mr. Guildroy.

Mr. **GUILDROY**. Thank you, Mr. Chairman.

My name is Jack Guildroy. I'm a member of the National Legislative Council of the American Association of Retired Persons.

AARP appreciates the opportunity to testify on the issue of employee benefits and the need for a national retirement income policy. AARP, the Nation's largest aging organization, represents the interests of over 18 million members.

The ultimate goals of changes in the income support structure serving older Americans must be the elimination of poverty and the reasonable guarantee that older persons will be able to achieve and maintain an adequate retirement income.

To be adequate, an older person's income should be sufficient to prevent a significant decline in the living standard achieved earlier in life. Social Security must continue to be relied upon to provide an important component of older persons' income.

As an essential supplement to Social Security and other forms of retirement income, AARP supports reform and expansion of the private pension system so that it becomes, over time, a more universally available and more reliable source of significant amounts of income for the elderly.

A number of inadequacies in the private pension system need to be remedied. To start, present law should be amended to shorten vesting periods. Many employees do not remain with the same employer for 10 years, the required vesting time for most plan participants.

The highly mobile worker has as great a need for pension security as the worker who stays with a single employer. Yet, because of lack of vesting, the mobile worker may receive no pension or a significantly reduced pension from the last employer.

One problem that arises with shorter vesting periods is that small vested benefits are often cashed out in lump sums and are thus not preserved to provide for retirement needs. The objective of providing an adequate retirement income is therefore frustrated.

For this reason, a system of portability which enables an individual to transfer his vested pension credits is needed. Pension rights and credits earned by a worker are very rarely transferable from the pension plan of one employer to that of another.

With a workable system of portability, earlier vesting becomes more practical, and mobile workers in general will have the opportunity to receive a retirement income based on total years of employment.

In addition to the lack of coverage, the private pension system as a whole provides very little in terms of compensation for the inflation losses recipients sustain with respect to their private pension benefits.

If the future elderly are to be better able to maintain their living standards throughout their later years of life, ways must be devised to mitigate the effect of inflation on private pension benefits from the time they're awarded.

Current integration provisions which allow pension plans to coordinate with Social Security represent another problem in meeting the goal of adequate retirement benefits.

While replacement rates provided by Social Security are tilted toward the lower paid, it's clear that low-income individuals need the supplementary retirement income provided by private pensions to maintain an adequate living standard.

The general thrust of Tax Code provisions and private pension laws has been to expand broad receipt of benefits. It is thus inconsistent and unfair to allow plans to integrate with Social Security so that lower paid workers receive maximally reduced benefits.

Another inconsistent feature of pension law that requires change is the treatment of pension accrual for employees who continue to work beyond the normal retirement age.

EEOC's new proposed regulations, based on consistency with the Age Discrimination in Employment Act, would require accrual beyond age 65 and would halt the practice of nearly half of all pension plans that currently freeze pension credits at age 65.

Since the cost to employers is insignificant and older workers would be accorded the same rights as those under age 65, Federal policy should mandate accrual beyond the normal retirement age.

Tax policy must not ignore the social desirability of current pension practice. The long-term needs of our retirement system for fairer and more expansive private benefit plans should not take a back seat to short-term revenue needs.

While there is a clear need to bring budget deficits under control, tax policy should seek to further, not to destroy, the gains made in the private pension system so that it becomes over time a more reliable, efficient, and universally available source of retirement income.

Thank you, Mr. Chairman.

[The prepared statement of Jack Guildroy follows:]

Prepared Statement of Jack Guildroy, National Legislative Council, American Association of Retired Persons, Washington, DC

The American Association of Retired Persons appreciates the opportunity to submit comments on the issue of employee benefits and the need for a national retirement income policy. AARP, the nation's largest aging organization, represents the interests of over 18 million members.

The ultimate goals of changes in the income support structure serving older Americans must be the elimination of poverty and the reasonable guarantee that older persons will be able to achieve and maintain an "adequate" retirement income. To be adequate, an older person's income should be sufficient to prevent a significant decline in the living standard achieved earlier in life. Social Security must continue to be relied upon to provide an important component of older persons' income. But to achieve the adequacy goal, Social Security will have to be supplemented by income from private sources, particularly employment, private pensions, savings and other income producing assets. To the extent that income from all sources fails to provide an income above the poverty threshold, then the underlying public assistance programs should be made sufficient to guarantee at least a minimum income above that threshold.

Older Americans are especially vulnerable to adverse economic trends. High and sustained inflation during the past decade eroded the assets component (private pensions and savings) of their income, forcing them to become increasingly dependent on public programs. At the same time, inflation drove up the costs of these public programs while other adverse economic trends (high unemployment, low economic growth, etc.) restricted the revenue needed to meet those costs. As a result, the financial soundness of these public programs, particularly Social Security, was undermined and large-scale cutbacks in them were enacted.

The statistics provide a good indication of just how vulnerable elderly persons are to further reductions in retirement income. In 1983, the aged poverty rate stood at 14.1% representing 3.7 million persons, and the aged near-poverty rate (defined as the percentage of persons with income within 125% of the poverty threshold) was 22.4%. Because so many older persons are concentrated just above the poverty threshold, a relatively small drop in income would cause the aged poverty rate to escalate dramatically.

Older Americans are relatively more economically vulnerable than the rest of the population. In 1983, the median income of elderly-headed households was only $11,781—less than half the median income level of non-elderly households. In addition, while 43% of elderly-headed households had incomes below $10,000, only 18% of non-elderly headed households were in this income category. Even adding the value of in-kind benefits that older persons receive (such as health insurance, housing, food stamps, etc.) cannot change the fact that millions of older persons subsist on relatively low, and in many cases, extremely inadequate income.

Older women tend to be one of the most disadvantaged and hence vulnerable groups among the older population. They comprise nearly three-quarters of the total aged population in poverty. Older women, particularly minorities or those who are single and in their 80s, experience a very high poverty rate—a rate as high as 70% for black women living alone age 85+. Older women are also most likely to have no significant source of income other than Social Security. For this reason, median income for elderly women in 1983 was only $5,600, just $825 above the official poverty level.

The private pension system's failure to provide universal coverage, adequate inflation protection, early vesting and portability of pension rights and credits has seriously constricted its importance as a reliable source for a significant amount of supplemental retirement income. Clearly, Social Security has been far more successful in overcoming the inadequacies associated with private pensions. However, two majors factors, Social Security's financing mechanism and future financing problems, make it unlikely that Social Security alone could ever provide an adequate retirement income and displace the private pension system.

As an essential supplement to Social Security and other forms of retirement income, AARP supports reform and expansion of the private pension system so that it becomes, over time, a more universally available and more reliable source of significant amounts of income for the elderly. A number of inadequacies in the private pension system need to be remedied. Currently, only about 25% of persons age 65 and over receive private pension benefits. Moreover, since less than half of all workers in the private sector are covered by a pension plan and only about 25% of the total working population age 18 and over has acquired a right to receive benefits ("vested") from a pension plan provided by their current employers, the private pension system is likely to continue to fall far short of being the universally available source of supplemental retirement income that it should be.

Necessary changes are needed to assure that the private pension system will provide a more significant and more available share of the income of the future elderly. To start, present law should be amended to shorten vesting periods. Many employees do not remain with the same employer for 10 years, the required vesting time for most plan participants. On average, a male worker has been with the same employer about seven years, while for women, that figure drops to only about five years. The highly mobile worker has as great a need for pension security as the worker who stays with a single employer, yet because of lack of vesting, the mobile worker may receive no pension, or a significantly reduced pension from the last employer.

While immediate vesting, at least for a minimum benefit level, may be the ultimate goal, it is clear that a vesting period significantly less than 10 years is currently essential. Some may argue that the cost increase is too great, but the need to move toward greater coverage far outweighs the costs involved.

One problem that arises with shorter vesting periods is that small vested benefits are often cashed out in lump sums, and are thus not preserved to provide for retirement needs. The objective of providing an adequate retirement income is therefore frustrated. For this reason, a system of portability, which enables an individual to transfer his vested pension credits, is needed. Pension rights and credits earned by a worker are very rarely transferable from the pension plan of one employer to that of another.

One potential approach is the establishment of a central clearinghouse, which could act as a "bridge" between pension plans so that when workers change jobs, funds can be transferred and maintained for retirement needs. Another possibility is the requirement that a lump sum be deposited in a rollover IRA, with access denied until retirement. Either approach would relieve the potential administrative burden placed upon the employer attempting to administer a number of small vested pensions.

The need for a system of portability is greatest for lower income workers, who are the most likely to spend lump sum payments, and who are the most in need of an adequate pension in the future. With a workable system of portability, earlier vesting becomes more practical, and mobile workers in general will have the opportunity to receive a retirement income based on total years of employment.

In addition to lack of coverage, the private pension system as a whole provides very little in terms of compensation for the inflation losses recipients sustain with respect to their private pension benefits. Although many plans provide ad hoc adjustments, only about 5% of all pension plans provide automatic inflation adjustments. Even these adjustments are usually limited to a maximum of about 3% a year. The average American retiring at age 65 has a life expectancy of about 17 years. If one assumes an inflation rate of 5%, the average pension recipient will suffer a 56% reduction in purchasing power to his fixed pension in 17 years. Higher rates of inflation will be even more devastating.

If the future elderly are to be better able to maintain their living standards throughout their later years of life, ways must be devised to mitigate the effect of inflation on private pension benefits from the time they are awarded. Under the present legal framework, the Association knows of no mechanism for mandating cost-of-living adjustments without risking massive pension plan terminations by employers because of the large cost increases the making of such adjustments would entail. However, employers could be induced to provide at least some inflation compensation to their retirees through, for example, tax breaks, the extension of federal labor law to specify that retirees' benefits are a mandatory subject of collective bargaining, and the issuance by the federal government of indexed bonds that would be available to private pension plans and would guarantee a real rate of return on investment.

Also, retirees must have the opportunity to take part in their pension plan's decision-making process; for example, positions on the plan's board of trustees should be available to retirees. When investment returns make it affordable, retirees must be able to argue to plan sponsors that some portion of their plan's liberalizations should be devoted to cost-of-living protection for retirees.

Another practice that has recently worked to the detriment of plan participants is the increasing trend of terminations for the purpose of recovering excess assets. Several billion dollars have been recaptured in the past few years, and current PBGC termination applications show there is little slowdown. This recapture of surplus funds by the employer fails to account for the future needs and expectations of retirees and plan participants. Retirees in plans that have been terminated will have their benefit amounts frozen at the current level. The impact of inflation on the real value of benefits will erode retirement security with little chance for inflation adjustment.

The current accelerated trend of pension plan terminations is a clear signal that the law is inadequate. One possible solution is the allocation of the excess assets among both the employer and plan participants. Using excess assets to reduce the negative impact of inflation on post-retirement benefits is rational when considered in light of the fact that high interest rates, associated with high inflation rates, helped account for the surplus initially.

Another problem in meeting the goal of adequate retirement benefits are the current integration provisions, which allow pension plans to "coordinate" with Social Security. While private plans generally must not discriminate against lower paid employees, an employer may consider contributions to Social Security in determining benefit amounts. The end result of integration rules is that payment to higher-income workers is encouraged, while lower paid workers may have their benefits substantially reduced or altogether eliminated.

While replacement rates provided by Social Security are tilted toward the lower paid, it is clear that low income individuals need the supplementary retirement income provided by private pensions to maintain an adequate living standard. The general thrust of tax code provisions, and private pension laws, has been to expand broad receipt of benefits. It is thus inconsistent, and unfair, to allow plans to integrate with Social Security so that lower paid workers receive maximally reduced benefits. In addition, the fact that plan participants pay for pension benefits through reduced wages makes it difficult to justify denying benefits to lower paid workers.

Another inconsistent feature of pension law that requires change is the treatment of pension accrual for employees who continue to work beyond the normal retirement age. Currently, Equal Employment Opportunity Commission regulations, adopted from the Department of Labor, have allowed employers to halt pension crediting to workers who continued employment beyond age 65. EEOC recently rejected this interpretation as contrary to the purpose and intent of the Age Discrimination in Employment Act, which prohibits discrimination between ages 40 and 70. EEOC's new proposed regulations would require accrual beyond age 65, and would halt the practice of nearly half of all pension plans that currently freeze pension credits at age 65.

Current law creates a disincentive to continue work, and presents the employee with a "no win" situation. The employee who must continue working due to economic necessity may find he is no better off since his pension remains the same despite 5 additional years of work. Older workers may in fact lose some of their benefits if the plan's payments do not commence until the worker actually retires. Since the cost to employers is insignificant, and older workers would merely be accorded the same right as those under age 65, federal policy should mandate accrual beyond the normal retirement age.

Given current economic and demographic trends, government policy ought to strongly encourage greater labor force participation by older workers. Such increased employment activity would generate additional tax revenue for use at all levels of government. In addition, continued labor force participation would ease the strain on the Social Security trust fund in two respects: the tax income to the trust fund would increase, and the pay-out from the fund would decrease. The economy in general would benefit from the added value of goods and services produced. Older Americans would benefit by being able to supplement their income from other sources with income from employment, thus increasing their ability to maintain their standard of living and do it with a form of income (wages) that has better prospects for keeping up with inflation than most other forms of income. Finally, the share of older persons' total income that comes from their own work effort represents a share that need not be borne by other workers through transfer programs.

One component of a national older worker strategy must be the elimination of existing employment barriers, the greatest of which is mandatory forced retirement based on age. AARP recommends that forced retirement based solely on age should be completely prohibited under the ADEA.

AARP also supports enactment of an aggressive work promotion strategy designed to encourage and reward able-bodied older persons for continuing to work past age 65 and to discourage able-bodied older workers from retiring early. Components of this strategy would include: 1) the elimination of the Social Security earnings limit for persons age 65+; 2) an increase in delayed retirement credits for persons who delay filing for Social Security benefits until after age 65; 3) a gradual increase in the early retirement disincentive, phased-in in the future (from the current 20% reduction to a 30% reduction at age 62); and 4) elimination of the requirement that states reduce a person's unemployment compensation by the amount of a pension income received.

A major feature of a work promotion strategy should also be the encouragement of part-time work among older employees. Many difficult questions arise with respect to pension crediting, and any serious look at a national retirement policy must be able to effectively deal with the issues of part-time work.

In addition to private pension plans, Social Security, and continued employment options, other savings and retirement income instruments, such as IRAs, must continue to be relied upon as potentially significant sources for supplementing income during the later years of life. Privately accumulated savings must also be relied upon to contribute significantly to the income of older Americans.

New sources of retirement income must also be explored, and one potentially important new income source is reverse equity. Under this type of financial arrangement, it would be possible for an older person to turn the appreciating value of a home into a steady source of income while still retaining both possession of the home and title to it during the person's lifetime. A study of the 1977 Annual Housing Survey revealed that one-fourth of low-income older homeowners could raise their incomes above the poverty threshold by drawing upon the equity in their homes. In many cases, reverse equity could enable elderly homeowners to remain living in their own home, self-sufficient, and better able to meet expresses for basic necessities, such as food an medical care. AARP believes that reverse equity, with appropriate safeguards, should be encouraged at the federal and state levels.

Along with the desire to develop better retirement income programs is the need to secure advance funding of a portion of the cost of providing an adequate income for the future elderly. Current pension practice, with its requirement of advanced funding, is increasingly desirable as a matter of public policy. This will assure that the post World War II baby boom population will, in effect, have savings of their own, and will not be totally dependent on a pay-as-you-go system for retirement income. A pay-as-you-go system, such as Social Security, would have to increase tax rates sharply to provide an adequate level of income for future retirees as a time when the worker/retiree ratio will be diminished. Additionally, since funding provides savings to finance investment, the private pension system is looked upon increasingly as a mechanism for fostering economic growth.

Tax policy also must not ignore the social desirability of current pension practice. The long-term needs of our retirement system for fairer and more expensive private benefit plans should not take a back seat to short-term revenue needs. While there is a clear need to bring budget deficits under control, tax policy should seek to further, not destroy, the gains made in the private pension system, so that it becomes, over time, a more reliable, efficient, and universally available source of retirement income.

Mr. **Kildee**. I thank both of you for your testimony.

I have one question. You mention the portability. Do you have any suggestions for the Congress as to how we could design a portability system for pensions?

Mr. **Guildroy**. There are at least two suggestions that have been floated, I know. One is to set up some kind of a clearinghouse to take care of the situation where small sums of money are involved. Another possibility is to transform what has been earned by rolling the amount over into an IRA. I'm sure there are other possibilities.

Ms. **Friedman**. Yes. I think there are lots of proposals that are now being developed. The two that he mentioned are certainly possibilities.

I think that the concern is to come up with a system that, on one hand, allows mobile workers to take that money and roll it over into an interest-bearing account; however, from the employer's perspective it must be a system that is not going to hurt the funding of plans.

Mr. **Kildee**. Mr. Hayes.

Mr. **Hayes**. I'm not sure which Karen you are.

Ms. **Friedman**. I'm Karen Friedman. I'm representing the women's pension project.

Mr. **Hayes**. All right.

Ms. **Friedman**. However, that is an activity of the Pension Rights Center.

Mr. **Hayes**. I notice you are in favor of reducing the vesting from 10 to 5 years, and I just wanted to ask Mr. Guildroy, what's your reaction to that?

Mr. **Guildroy**. AARP's reaction is generally very supportive of that, except, so far as I know, we have not taken a position on the exact number. Five years might be a very reasonable alternative to the present ten. We know the 10 is not adequate—does not safeguard the interests of workers. Five would seem to be reasonable, but this is not the official policy of our association.

Ms. **Friedman**. Actually, the position that the women's groups have taken on this—the women's pension project and the women's groups—is that vesting should be reduced now to 5 years and, over a period of time, reduced to 3 years. There are still going to be a lot of people, especially women, who are going to be left out of the 5-year vesting requirement, so that we think that 3 years is even more reasonable.

Mr. **Hayes**. What is your reactions, or both of your reactions, to lengthening the retirement age from the current accepted 65 or 62 to 70, which has been talked about?

Ms. **Friedman**. Well, do you want to take the question, and then I'll respond?

Mr. **Guildroy**. I'll try that.

As some of you may know, we were opposed 2 years ago to increasing the age at which full Social Security benefits are available.

We believe, on the one hand, that there should be incentives to encourage persons to work longer periods of time. We feel that there are very many benefits from this.

On the other hand, we're very well aware that there are many persons who are unable to work, for health reasons, for other reasons, and we regret seeing that 65 figure going up to 67 for the full Social Security benefits later on. For the same reason, we would object to it on this particular issue.

Mr. HAYES. Thank you, Mr. Chairman.

Mr. CLAY. Mr. Owens.

Mr. OWENS. No questions, Mr. Chairman.

Mr. CLAY. I'm sorry that I was not here to hear your testimony; I was called out of the meeting room; but I assure you that I will read it.

And who has just walked in?

Ms. FERGUSON. Karen Ferguson.

Mr. CLAY. And Ms. Ferguson, we will insert your entire statement in the record. I'm sorry that you were not here, but we have some serious time constraints. In fact, the Democratic caucus is meeting now. So we're going to have to speed up the final panel and get over to the caucus meeting.

[Prepared statement of Karen Ferguson follows:]

PREPARED STATEMENT OF KAREN W. FERGUSON, DIRECTOR, PENSION RIGHTS CENTER

Mr. Chairman, Members of the Subcommittee, I am Karen W. Ferguson, Director of the Pension Rights Center. The Center is a nonprofit public interest group organized nine years ago to educate the public about pension issues and to protect the pension rights of workers and retirees.

Mr. Chairman, my remarks today will be brief and will reflect my personal observations and responses to the five questions you posed yesterday at the opening of these hearings.

1. You asked whether we have a national retirement policy. My answer is no, we do not, but we came very close to having such a policy as recently as four years ago. While that policy was never formally articulated by Congress, there seemed to be something approximating a consensus among pension policy-makers and professionals as to its broad outlines.

This policy was that after a lifetime of private sector employment a lower or average income worker should be able to retire on an income that would provide the basic necessities for a modest standard of living. It was generally agreed that the sources of that income should be social security and an employer paid pension. This policy translated into 1985 dollars would mean that a typical retiree receiving a little more than $5,000 a year from social security should receive pension income of about $3,000 a year. It was assumed that since lower and average income workers cannot afford to start saving early enough in their careers or in large enough amounts, voluntary savings would play little or no role in providing their retirement income.

Near agreement on retirement income goals, of course, did not mean agreement as to how to achieve those goals. But it did mean that improvements in employer paid pension plans were to be the route by which these goals would ultimately be reached.

2. You ask, as your second question, "Is an articulated national policy necesary?" The answer is, emphatically, yes. We strongly support Congressman John Erlenborn's suggestion that such a policy statement be included as part of the preamble of future pension reform legislation.

3. You also asked what workers can expect in retirement as the result of current policies. If your question is addressed to pension policies, the answer can only be "it depends." Our pension system provides extremely generous benefits for some retirees, modest benefits for many, and little or no benefits for most retirees.

Although the proportion of retirees receiving pensions will increase in the future as the result of recent reforms, absent major restructuring of the private pension system, a majority of retirees will continue to lose out. This is because plans are typically designed so that shorter service workers pay the pension of longer service workers, and lower paid workers pay the benefits of the higher paid. Those likely to receive the least—or nothing at all—will continue to be the people most in need of pension income to supplement their social security payments, the people who write our office, as I'm sure they do yours, saying, "I can't make it."

4. Your fourth question, was "What should our national retirement income goals be and how can we achieve them?"

Our national retirement goal should be a fair and adequate retirement income system. Congress can achieve this goal by:

First, resisting any attempt to cut back or freeze social security benefits.

Second, reinstating the Bureau of Labor Statistics Retired Couples' Budget. This Budget, eliminated in 1982, would provide a realistic benchmark to assess what, in dollar terms, the private pension system must provide, over and above social security, to allow an individual to live at a minimally decent level.

Third, removing all tax subsidies for voluntary savings. The reason I said at the outset of my statement that we no longer have a consensus on what a retirement income policy should look like is that many policy-makers now appear to be intrigued with the concept of "do-it-yourself retirement." We think that this concept is dangerous and unrealistic.

As the direct result of the advent three years ago of IRAs-for-everybody and more recently, 401(k) plans. many employers have stopped improving their pension plans. Some have even terminated their pension plans and substituted 401(k)s or told their employees to set up IRAs for themselves. This makes no sense. All of the evidence points to the fact that those most in need of a supplement to social security are not contributing to those plans. According to an article in the March 19, 1985 Wall Street Journal, 72 percent of all U.S. households have not opened IRA accounts, more than 70 percent of these households said they couldn't afford an IRA. The people who are benefitting from tax sheltered voluntary savings arrangements are those who already have other sources of income and would save for retirement without a tax incentive.

To the extent employers' enthusiasm for these plans can be traced to cost savings, consideration should be given to allowing salary reduction arrangements within conventional pension plans, but only over and above a minimum level of employer paid benefits.

Fourth, making explicit the promise implied in pension plans that once a pension plan is set up it will continue as long as the company continues unless it is in the interests of plan participants for the plan to terminate. (This would be the case if plan assets were needed to save a company, and with it participants jobs and expected pensions.) Under no circumstances should employers be permitted to "raid" a pension plan to further corporate purposes that are not in the interests of plan participants.

Fifth, redefining the concept of a pension to make plain that in order to receive tax favored treatment, funds must be held until a participant's retirement age (or death or disability) and then paid out in the form of an annuity.

Sixth, revising the tax preferences now provided to non-pension plans, such as profit sharing and savings plans and ESOPs.

Seventh, requiring the Bureau of the Public Debt to promote a non-integrated Simplified Employee Pension Plan funded by high yield U.S. Retirement Plan Bonds. Although SEPs are a simple, inexpensive way of providing pension coverage to workers in small companies, few employers know about these plans. A promotional campaign by the Bureau of the Public Debt, emphasizing the need for pension income to supplement social security, would encourage employers to adopt SEPs. It would also encourage financial institutions to conduct similar campaigns. The Bureau of the Public Debt could withdraw from the sale of U.S. Retirement Plan Bonds, as it did in the case of IRAs, when it found that it could no longer compete with private institutions.

Eighth, and most important, revising ERISA and the Internal Revenue Code to assure: That no workers employed by an employer be excluded from a plan; that, to the extent cost and administrative considerations permit, workers receive pension credit for all the years they work; that pension benefits not be integrated with social security except, possibly, in the case of the occasional full career worker whose pension and social security combined are substantially more than he or she earned before retirement; that, at the option of employees, pension money be transferable to other plans when a worker leaves a job; and that, to the extent investment return and forfeitures (attributable to the deaths of people dying without surviving spouses) permit, benefits be adjusted to reflect increases in the cost of living.

5. Finally, you ask, "What impediments exist . . . which make it difficult to achieve our goals?"

There are two major impediments to the development of realistic retirement income policies. The first is a confusion on the part of many policy-makers as to the purpose of pensions.

There is no question as to the original purpose of pensions. Employers set up pension plans to attract workers, retain them, and ease them out of the work force when they were considered to be no longer productive. The issue that must be resolved now is whether this "management tool" function of pensions is still an acceptable purpose of the system. If it is, only the most minimal reforms will be possible. To take only one example, five or three year vesting is completely inconsistent with the use of pensions as reward for loyal service or a "golden handcuff" to hold workers to their jobs.

Quite frankly, we thought this issue had been resolved ten years ago with the enactment of ERISA. Senator Jacob K. Javits, principal author of the law, thought so as well. In a speech he delivered two weeks after ERISA was signed into law Senator Javits said,

"Whatever lingering doubts may have persisted prior to its passage, the law tells us that private pensions are a form of deferred wages and not a form of gratuity to be offered and withdrawn at the whim of the employer. In short, the "gold watch" theory of pensions is dead for once and for all." [1]

But now we are hearing that large employers are taking the position that they will not continue their plans if they cannot be used to shape their work force, and that small employers won't set up new plans unless they can be significantly skewed to favor company officers. These claims need to be scrutinized carefully before the retirement income debate can continue in earnest.

If employers see pensions primarily as management tools, are they efficient in fulfilling that purpose. What about the hundreds of thousands of employees who were unable to be "loyal" to their employers during the recession? Are there other incentives that can serve employer interests as well, higher pay, bonuses, more challenging work, or improved working conditions?

Also, how does the view that pensions should serve corporate purposes square first, with the workers' conception of pensions as money they have earned, wages they have given up? Should the only money that can realistically supplement their social security payments be dependent on employer concerns that have no bearing on retirement income needs? Most important, how can American taxpayers be asked to continue to subsidize so heavily a program structured principally to meet employer needs rather than the broad social policy objective of an adequate retirement income system.

Many people believe that it is just a matter of time until the tax committees start to take a hard look at this largest of all federal tax expenditures. Before they do, it would be helpful were this Subcommittee to begin the process of attempting to clear up this confusion.

The second major impediment to reaching retirement income goals is related to the first. Is it really likely that if employers are not able to use pensions to meet their personnel needs, will they jettison their plans? Certainly, this is the argument that Congress has heard each time pension reforms have been proposed. Is the threat real? It has not proven to be so in the past, but now the reforms being proposed are much more far-reaching. Are fair pension plans impossible in a nonmandatory system? How precarious is the pension system's delicate balance between voluntarism and regulation. I suggest that this needs to be examined directly in an open dialogue with employers.

My guess is that what you will find is that it is more often those who sell and service pension plans who will threaten the demise of the system. Employers are increasingly sensitive to the retirement income needs of their workers. They are also aware that there is no other means of providing themselves with a tax deferred arrangement that will provide them with funded benefits of up to $90,000 a year for life.

Employers, as distinguished from their actuaries and lawyers are also very much aware of the role of pensions in providing much needed capital for their operations. The almost one trillion dollars in pension fund assets now holds more than thirty percent of the equities of American corporations. Moreover, employers are able to invest up to ten percent of their pension funds in their own companies. For many employers the role of pension funds as the nation's largest source of private capital is their single most important function.

---

[1] Briefing Conference on Pensions and Employee Benefits, Sept. 19, 1974.

Finally, I think you will find that, if pressed, employers will tell you that they will not terminate their pension funds simply because they are aware that it is only the existence of the private pension system that has kept social security benefits at their present low levels. If employers reject the pension system, the only realistic alternative will be to increase social security benefits. The political climate that makes that unlikely today would quickly change if their were widespread terminations of pension plans. Only if there is a full and open dialogue on this subject will it be possible to work toward the development of a retirement income system that meets the needs of all American workers.

Mr. Clay. So I certainly want to thank everybody for attending this morning. Thank you.

The next witnesses will be a panel consisting of Richard Fay, Robert Krinsky, and Robert Lebenson.

Good afternoon, gentlemen. Without objection, your entire statements will be included in the record at this point, and we ask you to summarize and hit the highlights of each statement.

Mr. Fay.

STATEMENTS OF RICHARD H. FAY, PARTNER, REED, SMITH, SHAW & McCLAY, REPRESENTING THE U.S. CHAMBER OF COMMERCE; ROBERT KRINSKY, PRESIDENT, MARTIN E. SEGAL CO., REPRESENTING THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS; AND ROBERT D. LEBENSON, PRESIDENT, AMERICAN SOCIETY OF PENSION ACTUARIES

Mr. Fay. Good afternoon.

My name is Richard Fay. I'm an attorney in private practice. I'm here today representing the U.S. Chamber. With me is Jim Klein, director of employee benefits of the chamber.

We are grateful, as the other people testifying have been, for the committee allowing us to testify, and I'll keep my comments mercifully brief.

First, I want to note that on this issue, the chamber and the house of labor are united. We share the same interests and the same goal, and that is to try to convince the Members of Congress, and specifically this committee, that the proposed tax treatment increasing the cost of employee benefits is not sound retirement policy.

One of the arguments given for taxation is that these benefits are for the privileged few.

In our testimony we prove statistics showing that a bulk of Americans, and low-paid Americans, are covered under these programs.

We also would like to make the point that not only are a great many Americans provided health and pension benefits, but it has been provided at a great savings—past savings—to the Federal Government.

If the private system were not providing these benefits, the Congress would have no choice but to provide them by some national program. But in fact there is no alternative; there is no alternative, other than encouraging private systems, because social security will not be able to increase the level of benefits currently provided.

So repealing favorable tax treatment of employee benefits rather than saving the Government money, will in fact cost the Government and cost them big.

I know that you have many pressing matters, so I will conclude my statement now and hope that there will be some questions.

Thank you.

[Prepared statement of Richard H. Fay follows:]

PREPARED STATEMENT OF RICHARD H. FAY, REED, SMITH, SHAW & MCCLAY, STATEMENT ON BEHALF OF CHAMBER OF COMMERCE OF THE UNITED STATES

My name is Richard H. Fay, and I am a partner with the law firm of Reed, Smith, Shaw & McClay. I am testifying on behalf of the U.S. Chamber of Commerce, the world's largest federation of business companies, chambers of commerce and trade and professional associations. I serve on the Chamber's Employee Benefits Committee and chair its ERISA Subcommittee. Accompanying me today are Frederick J. Krebs, Director of Employer Relations, and James A. Klein, Manager, Pension and Employee Benefits, for the Chamber.

We welcome this opportunity to express the Chamber's support for a strong, voluntary, private-sector employee benefits system and for a national retirement income policy that serves the needs of America's retired men and women.

During the coming months, this Subcommittee will be examining many important pension and welfare benefit issues. The Chamber looks forward to working with the members of the Subcommittee and its staff on specific proposals. Unfortunately, today several legislative proposals would impose new taxes or limitations on the private pension system, thereby adding to the difficulty of this country's ability to meet the needs of retirees.

We recognize that proposed amendments to the Internal Revenue Code are not directly within the jurisdiction of the Education and Labor Committee. However, the widely publicized proposals to tax employee benefits, contained in the U.S. Treasury's proposal and a host of Congressionally-initiated measures, are inextricably related to the Education and Labor Committee's mandate to oversee pension and welfare matters.

The importance of the threat to our employee benefits system from the proposals to tax benefits cannot be overstated. Rarely in recent memory has an issue so unified business and the labor community; their mutual concern and opposition have been expressed over the efforts to tax employee benefits. Business and labor are working in concert on this issue to convince the Congress that altering the tax treatment of benefits would be unwise and shortsighted.

These hearings are a much-needed opportunity to evaluate how well various tax provisions foster and encourage private employee benefits and how well these private programs, in conjunction with public programs such as Social Security, will meet the growing needs of retiring Americans.

Thus, I would like to begin my testimony by briefly describing the significant achievements of the current private employee benefits system. Then I shall discuss some of the questions the Subcommittee has posed as topics for these hearings.

WHAT OUR EMPLOYEE BENEFITS SYSTEM HAS ACCOMPLISHED

1. Substantial Welfare and Retirement Benefits Provided for More than 40 Years.—The private employee benefits system has provided substantial welfare and retirement benefits for American workers and their families for more than 40 years. The programs comprising this system are broadly-based, providing pension, medical, disability and life insurance benefits for many workers and their dependents.

Taxing employee benefits is frequently justified on the assertion that they are only "fringe" benefits for the privileged few. Nothing could be further from the truth. Private employee benefits plans provide benefits to 150 million employees and dependents. Over one million employers are providing retirement and welfare plan benefits. The Employee Benefit Research Institute has documented that almost 95% of all full-time, nonagricultural employees in medium to large size firms are provided life, health and disability insurance and that 75% of these employees participate in retirement benefit plans.

Equally important, these benefits are available to a broad range of the work force and are not limited to just the highly paid. Over three-fourths of employees participating in private pension plans earn less than $25,000. Among employees with vested pension rights, 70% earn less than $25,000 and of employees with health insurance, 80% earn less than $25,000.

2. Maintenance of a less extensive and less costly Social Security system and avoidance of the burdens and problems of a broadly-based national health system.—During the last forty years, provisions of the Internal Revenue Code have assisted in the growth of the most advanced health care and the largest private pension system in the world. These provisions have made it possible for our government to avoid many of the problems and burdens that other developed nations have experienced in implementing national retirement and health care systems. In hindsight, the early Congressional advocates of the private pension system were extraordinarily astute visionaries when they argued that the alternative of government-provided programs would be many times more expensive.

3. Government and private sector cooperation.—We are pleased that this Subcommittee will be considering, among other things, the proper role and function of public programs. Government programs have proven generally to be costly, administratively cumbersome, rigid and limited in the benefits provided.

The government, of course, has a legitimate and important role to play. Social Security is a key element in any national retirement income system. Beyond that, however, government's main function has been and should be to provide incentives to encourage the private sector to assume the awesome responsibilities of providing a large, highly diversified and efficient private retirement system. This alliance between government and the private sector has proven effective and vitally important.

In light of the accomplishments of our employee benefits system, it is no surprise that the U.S. Chamber's Board of Directors recently unanimously reaffirmed its support of the use of tax incentives "to encourage the development of a strong, voluntary, nondiscriminatory private-sector employee benefits system, which can vary in accordance with needs of emloyees and employers." The Chamber, therefore, calls upon this Subcommittee to do its utmost to preserve and strengthen this system.

THE GROWTH AND COMPOSITION OF EMPLOYEE BENEFITS

Data compiled by the U.S. Chamber show that the private sector has responded to the challenge of providing pension and welfare security.

Since 1951, the Chamber has conducted a comprehensive survey of employee benefits. Thirty-five years ago, the Chamber noted the scarcity of statistical information about the scope and nature of employee benefits, and it decided to conduct biennial surveys on how much employers were spending for various employee benefits and on what types of benefits. Since 1977, the survey has been conducted annually. Our latest survey, the twenty-second, presents data collected for calendar year 1983 from 1,454 companies representing all types of industries and all regions of the country. This survey traces the growth of employee benefits from 18.7% of payroll in 1951 to 36.6% of payroll in 1983. As dollars per year per employee, the increase was from $644 in 1951 to $7,582 in 1983. In real dollar terms, of course, the increase is less significant.

Although 36.6% of the average payroll is now spent on employee benefits, concluding that over a third of total compensation escaped taxation would be erroneous. The Chamber's recent survey demonstrates that this is not the case. The 36.6% breaks down as follows: 9% of payroll was the employer's portion of legally required payments such as FICA taxes; payments for time not worked such as vacations, holidays and sick leave, which were fully taxed, accounted for 9.4% of payroll; the remaining 18.2% was for benefits that one typically thinks of as employee benefits (e.g. pensions, life and health insurance, lump-sum death benefits.) Much of the value these benefits, such as pension payments, is not tax-exempt but simply tax-deferred.

THE RESULTS OF TAXATION

If benefits become taxed, participation levels by employees and employers likely will drop, or, alternatively, the level of the benefits may be lower and the concept of low-cost group life and health insurance and private pension coverage will be undermined. Employees will be forced to pay tax on the imputed income value of employee benefits (including pension contributions)—not on actual dollars received—and they will, therefore, have less take-home pay. Many younger workers, naturally more concerned with immediate financial needs than potential retirement, will choose not to participate in pension plans. This will bring higher cost pressures to bear upon employer sponsors and those employees (mostly older workers) who will want to remain participants in pension plans. Likewise, because of the tax on employer-sponsored insurance plans, healthier workers will forego health or even life insurance—thereby leaving the higher-risk candidates as the participants of these plans.

In the end, our private-sector retirement and medical insurance system will begin to crumble because the concept of broad-based participation by young and old alike will no longer make sense to all workers. Invariably, this will mean more pressure on the taxpayers to provide health care and retirement income security to those who, for understandable economic reasons, dropped out of private pension and health plans.

SUBCOMMITTEE QUESTIONS

With these general comments as a framework, let us address some of the specific inquiries of the Subcommittee.

1. What are reasonable retirement income goals and what means can be developed to achieve them?

The nation's retirement income goal must recognize the economic needs of retired men and women who contributed to our nation's economic growth through their years of work. The approach must be pluralistic with various forms of income—personal savings, investments and private pensions—building upon the basic floor of economic protection afforded by Social Security.

The nation's recent experience with Social Security funding and the actuarial projections of the likely number of contributors in relation to the likely number of recipients of Social Security clearly indicate that this nation cannot rely on Social Security to increase its share of the amount of retirement income provided. Thus, the other two components of retirement income—savings and investment and private pensions—must be strengthened and encouraged. The proposals to eliminate 401(k) plans and to tax pension contributions certainly move in the wrong direction. Rather, we should allow the flexible retirement savings plans that have flourished in recent years to continue to expand in order to meet the growing challenge of providing retirement income.

2. What should be the essential components of a national retirement income policy (including the relative roles of governmental, individual and employer-sponsored programs)?

The main components of a national retirement income policy are described above in the answer to question number one regarding the pluralistic approach that the Chamber advocates. A national retirement policy must recognize the interaction of the government, the individual and the employer. Congress' purpose should be to facilitate the growth and viability of these components by minimizing regulatory costs and other administrative burdens.

Such costs and burdens only serve to discourage fuller participation by employers and employees in the employee-benefits system and to place a greater reliance on the public sector. In a shift from the private to the public retirement system lies the potential of enormous drains of public funds.

3. Of what importance are welfare benefits, such as health and life insurance, in providing retirement income security?

The Chamber strongly supports a voluntary, private system of health insurance, through workplace group health plans, for workers and their dependents. As a component of this private benefit system, we support continuation of coverage after retirement, on a voluntary basis, as a supplement to Medicare.

According to the Employee Benefit Research Institute, only about 3 percent of all retirees have coverage under employer health plans. However, a substantial number of employers—primarily large companies—do cover retired workers. This coverage furnishes a valuable protection for retirees which should be encouraged as a matter of policy, particularly in light of cutbacks in Medicare and other government health programs.

Private health and life insurance plays a vital role in providing care at affordable costs to those who need it most—our elderly population. Unfortunately, the proposals to tax health insurance contributions above a certain level would only exacerbate the problems created by the Deficit Reduction Act of 1984 (DEFRA). DEFRA sharply reduced the tax deductions for Voluntary Employees' Beneficiary Associations (VEBAs), which are important vehicles for funding employee benefits. As a result, these tax proposals would only further hamper the ability to continue providing benefits to retirees.

4. How should a national retirement income policy be implemented and administered?

This question is integrally related to questions one and two. Different administrative criteria are applicable to the different components of the retirement system. For example, less oversight is needed with regard to individual investments and savings than is required over the Social Security system.

What is necessary is that Congress not work at cross-purposes with itself in encouraging a flexible retirement income policy. Specifically, jurisdiction by various agencies of government with an interest in retirement matters must by examined and duplication eliminated. In addition, when legislation is enacted, even such seemingly nonsubstantive matters as effective dates are very important, and such dates should allow ample time for plan sponsors to respond to the new dictates of the law.

CONCLUSION

Finally, that the private sector has an important role to play in ensuring retirement income security should be acknowledged. All aspects of a national policy—including tax policy—should encourage that participation. Enacting short-term revenue raising measures at the expense of long-term reliance on the carefully crafted system of private sector employee benefits is not a policy that will meet the needs of the nation's retirees. The policy of imposing taxes on the private employee benefits system will only weaken the private system. The Education and Labor Committee and this Subcommittee can and should have a crucial role in evaluating these tax policies in the context of the need to ensure a long-term national retirement policy that recognizes and meets the need of retirees. It is in this context that the Chamber urges the Congress to do its utmost to preserve and strengthen our private sector employee benefits system.

Mr. CLAY. Thank you.

Mr. Krinsky.

Mr. KRINSKY. Yes, Mr. Chairman. I, too, will keep my statement very brief, as long as the testimony is printed in the record in its entirety.

I am Robert D. Krinsky, president of Martin E. Segal Co., consultants and actuaries. I'm here today representing the Association of Private Pension and Welfare Plans, better known as the APPWP.

The association is a nonprofit organization founded in 1967 to foster the growth of this country's employer-sponsored group employee benefits system.

We represent over 475 organizations throughout the United States, both large and small employers, who sponsor plans, as well as the leading service organizations for private plans including banks, insurance companies, accounting, and actuarial and consulting firms.

Collectively, the APPWP's membership is involved directly with virtually all employee benefit plans.

I think our main thrust here, Mr. Chairman, is to be very pleased with these hearings and to encourage the development of employee benefits policy independent of the tax-writing committees.

We feel that the issues go far beyond the question, as some of the previous witnesses discussed, of the tax expenditure issues and the amounts of money that would be said to be saved by instituting new taxes on benefits or taking away tax deductions on benefits. The long-term effects must be looked at. Only by having a retirement income policy review, can that be accomplished.

Second, my statement concentrates on the complications that have been added to pension plans in the last few years with the tremendous amount of legislation that has served to discourage, employers, particularly small employers, from adopting pension plans. There's just an awful lot for them to handle, and, when faced with the complexities involved, they tend to put it off.

Also, along with that, are the very short effective dates for putting those changes into effect and implementing the new laws that have been passed. This has been a tremendous burden on employers. I think one of the things we would plead that you would consider, in recommending any legislative changes, is that those changes be put into effect over a reasonable period of time, so that well thought out plan changes can be made.

Last—and again departing from my prepared statement, the thing I would plead for most of all is to take great caution in relying on private savings or private initiatives—either the private savings in the pension area or private initiatives in the health insurance area. We just feel that they will not work and will be much more costly to the Government in the long run than will the encouragement of private plans.

Thank you, Mr. Chairman.

[Prepared statement of Robert D. Krinsky follows:]

PREPARED STATEMENT OF ROBERT D. KRINSKY, PRESIDENT, MARTIN E. SEGAL, CO. ON BEHALF OF ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS

Mr. Chairman, and Members of the Subcommittee: I am Robert D. Krinsky, President of the Martin E. Segal Company, and I am here today representing the Association of Private Pension and Welfare Plans ("the APPWP"). The Association is a non-profit organization, founded in 1967 to foster the growth of this country's employer-sponsored group employee benefits system. We represent over 475 organizations throughout the United States: both large and small employers who sponsor plans, as well as the leading support organizations to private plans, including banks, insurance companies, and accounting, actuarial and consulting firms. Collectively, APPWP's membership is involved directly with virtually all employee benefit plans.

We are delighted that you, Mr. Chairman, and your subcommittee, have taken the lead in ensuring that any sweeping changes in employee benefits policy are not examined only by those concerned with tax policy and the problems of federal revenue enhancement. In our view, it is critical that any examination of this nation's benefit delivery programs, have, as a central element, a primary focus on employees and the effect of fundamental policy shifts on their benefits support system during both their working careers and in their post-retirement years as well.

I'd like to begin with an issue which has often been overlooked in the last decade, as the Congress has repeatedly revisited, in a piecemeal fashion, the subject of employee benefits.

Those employers who sponsor employee benefit plans have simply been overwhelmed with changes in the law. We are close to, if not already beyond, the saturation point with respect to legislative upheaval: drastic amendments to the tax code, with virtually no adjustment periods, have begun to deteriorate the benefit plan base in this country. With each piece of legislation, employers are that much more reluctant to initiate benefit plans and that much more tempted to terminate their ongoing arrangements rather than bearing the expense and burden of massively amending the plans to comply with these almost annual changes. This attitude is graphically reflected by the disaffection with the growing complexity in the benefit plan area that has been caused by yet another set of legislative changes—most recently the passage of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), the Tax Reform Act of 1984 ("DEFRA") and the Retirement Equity Act ("REA")—or the issuance of yet another IRS, DOL on EEOC ruling under these laws. For large and small employers alike, these repeated changes in the basic rules of the game have been enormously confusing, expensive and disruptive. Plan amendments and substantial revision of the summary plan descriptions required under ERISA have been mandated yearly; benefit administrators are virtually unable to keep up with the new requirements in such a way that they can adequately answer questions raised by employees. The small plan market is particularly inelastic; as the number and complexity of requirements increase, the incentive to have a plan at all is significantly diminished.

We have seen only the most minimal public discussion of some of the most far reaching aspects of these legislative changes prior to enactment. And impossibly short effective date periods have afforded plans little or no time to gear up for the new rules. REA is a perfect illustration of this problem: the issues that have arisen since passage are voluminous and difficult; few of the thorniest problems had even been considered, much less rationalized during the legislative drafting and debate. Yet, many of the new rules took effect on enactment, with the remainder coming into play, for the most part, four months later. The confusion and misunderstanding is only heightened by the absence of prompt regulatory guidance from the Treasury—an impossible feat for them. If this Subcommittee could successfully establish the principle of a phased-in effective date for any new employee benefits legislation—with a one to two year standard lead time for complying with major changes—it will have gone far to alleviate the tremendous burden on employees and companies to acclimate to the new rules. Such a principle may also help to stem the tide of employer frustration with the expense and mechanics of these critically important employee benefit programs.

We commend the Subcommittee for its recognition of the need for a national retirement income policy. In the Association's view, any national retirement income policy must take into account the importance of employer-sponsored benefits made available to employees as a group. We think it inarguable that they have historically proven to be a more efficient and economical method of delivering benefits to American workers than government administered programs will ever be. While individual saving should be encouraged, it would be foolhardy to rely exclusively or even primarily on voluntary private savings as a wide-spread source of retirement income. It is widely acknowledged that private savings have failed to bridge the gaps in Social Security in the past.

Relying on individuals to take the initiative to identify and make adequate provision for the basic benefit security that they need would shift the responsibility for saving, and the risk for not saving, to employees. Employees would no longer have an employer assurance that they will all have equitable protection for their health care needs, provision for their dependents at their death, and for their retirement income. The movement towards employee assumption of the risk and responsibility for these benefits may well create a disparity of treatment among individuals, depending on their individual sophistication, foresight and financial ability to forego current consumption. Primary reliance on individual savings for basic financial security in retirement adds to those variables the chance that the state of the nation's economy and stock markets will be unfavorable at the time the account holder retires. It is possible that many employees would try to maintain their coverage and their level of benefits, despite the shift in the sponsorship of benefits from employer to employee. However, it may also be that severe economic conditions in the future could result in wiping out health, disability and retirement protection, similar to this country's experience in the 1930's, when individual arrangements failed.

Only two years ago, Senator Jacob Javits, a major architect of ERISA, testified that as of 1982, 75% of those individuals benefitting from defined benefit pension plans earned less than $50,000 and that the tax advantages of these programs benefitted more middle income individuals than the home mortgage deduction. He cautioned against too speedy an indictment of the private pension system in this country for failure to serve a broad cross-section of employees. In Senator Javits' view, we should be taking steps now to encourage the health and growth of advance-funded arrangements. As he pointed out, "it is none too soon to start amassing the kind of assets we will need for the 'baby-boom's' retirement."

But in the face of this advice, many on the tax-writing committees and in the Administration argue that employer-sponsored arrangements are not so critical. They applaud and encourage the expansion of IRA's, and they seek to impose new burdens on the establishment and maintenance of employer-sponsored plans. They do not understand the long term strains that will be placed on government at all levels if their faith in private savings is misplaced.

While the federal deficit and erosion of the tax base is of concern to all of us, it would be a grave mistake to act on the erroneous assumption that all employee benefits are forever lost to the tax base, or to disregard the social policy reasons for those tax-preferred arrangements. We fundamentally disagree with those who see employee benefit coverage largely as a tax issue, to be tinkered and experimented with through repeated amendments to the tax code. The APPWP believes that the benefits debate should not be conducted exclusively in the forum provided by the Treasury and the tax-writing committees. The type and level of benefits provided by employers is a critical social issue that should not be driven solely by its revenue implications. Indeed, the Treasury proposal suggests that its sweeping changes would be revenue neutral while its effect on employee benefits would be to increase revenue by $80.76 million in the next five years, thus extracting nearly 20% of the savings attributable to the entire proposal from the benefits area alone. We would be making a serious mistake if the discussion of how employee benefits can most effectively and efficiently be provided in this country is carried on only in the context of perceived tax shelter abuses.

The employer-employee relationship has generated the most comprehensive employee benefit package available to employees, and there is no evidence that the government could or would make sure that a comparable range of security benefits is available to the public at large or that the costs of the government doing so would be supportable. Not only is the package of benefits that employers can and do provide for their workers and families comprehensive, but it has developed into a flexible and needs-directed program that best serves the individual employee requirements at different stages of their lives. Moreover, in a period when the level and availability of government provided benefits is increasingly in doubt and increasingly costly, the need for the continued existence and expansion of private benefit programs cannot be overstated. As the baby boom generation nears retirement, the ability of the social security system to deliver at manageable cost levels will be stretched to its limits.

By the year 2020, the percentage of those over age 65 will increase from 11 to 16 percent. The number of individuals over age 85 will increase 79 percent by 1995. These statistics graphically demonstrate the enormous burdens that will be put on the social security system, a system which already relies on pay-as-you-go financing. As America's demographic balance changes, the system will be even more vulnerable to declining economic conditions because the number of active workers supporting retired beneficiaries will decrease by almost half when the baby boomers retire.

The social security system is also widely considered inadequate at middle or upper income levels. Currently, an average worker who retired in 1981 receives a benefit roughly equivalent to 47% of his pre-retirement earnings, although to replace his pre-retirement standard of living, he would need a 68% replacement rate. While the system is targeted to replace 42% of average pre-retirement earnings, the fact that it is skewed toward the lower paid results in a 61% replacement rate for employees earning the minimum wage and less than 28% replacement rate for employees earning $30,000 or more. Thus, even if the system were financially sound, it does not supply, across the board, the kind of retirement income security that the private system, in conjunction with social security, has led employees to expect. It becomes, then, even more critical to support and expand the private benefit system, both to provide the kinds of coverage which the government system does not provide, and to bridge the income gap between social security and an adequate retirement income.

In considering the efficiency of any long-range policy shift in the employee benefits area, attention also needs to be focused on those welfare benefits which protect employees and their families from catastrophic medical costs, loss of earnings during illness, and the financial hardships associated with premature death. This protection provides peace of mind to covered employees but also moderates against upward wage pressure. Employees who are unprotected from events such as these have vastly diminshed morale, productivity and attendance. In turn, their employers offer these benefits not only to ensure that the employees' performance is free from the insecurity of financial disaster in the case of family emergency, but also to enhance their own competitive position in attracting and maintaining good employees. These benefits are an important part of the foundation of stable and secure employee relations; moreover, they are a recognized and bargained for portion of the total employee benefit package. Any radical departure from these arrangements will surely detract from the welfare security of American workers in a manner that may well create long term costs for the government, and financial uncertainty, primarily for low and middle income workers.

The November 27, 1984 Treasury Report advances a new argument against the current Tax Code incentives for employee benefits: the need for horizontal equity. In the Treasury's view, employees covered by employer-sponsored group arrangements have an unfair advantage under the tax law over those employees whose employers do not provide such benefits. Unlike the more constructive response to arguments for vertical equity focusing on specific abuses, the Treasury response to the cries for horizontal equity is to reduce all employees to the lowest common denominator. In the area of health care, Treasury appears to be suggesting that there is some essential fairness in making everyone pay more for health care over the long term with no apparent recognition that, especially at low income levels, employees will not have, nor will they perceive themselves to have, the available resources to purchase the coverage on their own. If true horizontal equity is the social goal to be achieved, then it would be far more reasonable to expand the exclusion for individually purchased health insurance as well.

The other primary argument made by the Treasury is that the proposed health care tax cap will discourage "over-consumption" of health care. As noted earlier, the cap will far more likely discourage legitimate health care, especially among low income empoyees and the elderly. More important, however, is that the entire thrust of the argument is misplaced—there are far more efficient and effective ways to contain health costs.

While some of the increase in health care costs may be traceable to over-generous payment systems, by far the greatest share of the increase is due to factors totally unrelated to whether an employee is provided a tax benefit for medical costs. In this country, we now have an oversupply of doctors and hospital beds, and an undersupply of patients. This anomaly had led to "over-doctoring" in some cases, which can be roughly defined as too many unnecessary tests, too much unnecessary surgery, too lengthy hospital stays and too high a cost for these services. Employees are in the worst position to monitor these costs; whether surgery is required, or whether it must be done on an in-patient basis in the hospital, or whether particular generic drugs could be substituted for more expensive "brand name" drugs is simply outside the knowledge or confidence of the average patient. Capping the amount of benefits that can be received tax free will not make for more sophisticated consumers; the rich will buy additional care and the poor will suffer inadequate care, or be reluctant to have serious medical problems addressed at all.

The APPWP strongly believes that such a plan is unwise. In the rush to identify short term dollar savings, wrapped in the cloak of fairness and simplicity, we will have endangered the employer-sponsored, private sector initiated safety net for all American workers.

ERISA set the stage for, but did not fully articulate, a national retirement income policy. The various public and private retirement programs have been developed separately, without adequate consideration being given to how they interrelate in meeting retirement income needs. What is needed is a national retirement income policy which will spell out a set of principles to serve as a basis for improving and better coordinating such programs.

Among the issues which a national retirement income policy should address are—what is the level of retirement income that is appropriate for an individual as a goal of national policy; what role should individuals, employers, and the government play in providing such retirement income; how can the growth of individual savings for retirement and a private pension plans be fostered; what part retiree health coverage should play in a national retirement income policy; and, finally, what further changes should be made in the social security system?

Certainly a redefined or newly-defined national policy should be designed to work toward the long-term goal of sufficient retirement income for workers to prevent a significant reduction in living standards after retirement. Individuals and employers should be encouraged, through appropriate tax policy, to build on top of the basic floor of social security protection by providing sufficient additional retirement income and retiree health coverage to prevent not only a significant reduction in living standards after retirement, but also prevent the chance that a catastrophic illness after retirement will wipe out all or a significant portion of retirement savings. This initiative involves continuing and expanding the present tax treatment to encourage the growth of employer-sponsored pension plans, group savings arrangements and retiree health care programs.

Until the federal government coordinates its various policies relating to public pensions, private pensions, Social Security, savings and working by the elderly, disparities and inequities will exist. The type of employment chosen and the frequency and timing of job changes will influence the amount and kind of retirement income received.

ERISA strengthened the security of private pensions. However, inflation, the cost of complying with the strict standards, and the ever-increasing costs of meeting social security payments pose serious problems for the viability of the private pension system. While ERISA met the main expectations of the legislators, it did so at a substantial cost. ERISA has affected and has been affected by other retirement income policies, the interactions of which are changing the ways in which future Americans will finance their retirements.

On behalf of the APPWP, Mr. Chairman, I thank you for the opportunity to testify before the subcommittee today, and we look forward to working with you in the future on these critical employee benefits issues.

Mr. CLAY. Thank you.

Mr. Lebenson.

Mr. LEBENSON. I'll also try to summarize my summary as rapidly as possible and move on to questions.

My name is Robert Lebenson. I represent the American Society of Pension Actuaries, of which I'm president, and with me is

Edward Burrows, the chairman of our Government Affairs Committee.

ASPA is a professional organization of 2,000 members. A portion of our statement of purpose contains the words that "our purpose is to preserve and enhance the private pension system as part of a cohesive and coherent national retirement income policy." So in our official statement of purpose, we are on record as endorsing the establishment of such a policy.

As many of the speakers that have gone before me have stated, in our opinion, that policy should be largely related to a set of retirement income goals. Those goals, similar to the percentages published in the President's Commission Report in 1981, should be on a descending percentage order with the highest values going to those at the lowest income levels.

We believe that such a policy should also clearly recognize the significance of the three elements—the three-legged stool that has been spoken of earlier this morning.

In particular, we would like to urge that the committee recognize that the first two legs cannot be replaced by the third. Individual Retirement Accounts are not a substitute for either Social Security or private plans.

Our written testimony, which I will not go into in detail, includes an outline of legislative recommendations that we have made to the committee.

We are hopeful that, in view of the pace of legislation of the last few years, this legislation does not become enacted too rapidly. We believe that stability in the system is one of the key things that is needed.

I will highlight a few of the contents of that legislative proposal.

First, and perhaps of most significance, is the reintroduction of a series of incentives for formation of new plans in the small plan area. This was originally proposed by Senator Javits, I believe, in 1978, and reintroduced by Senator Williams in probably the following year.

This, together with another element of our legislative proposal, which is a removal of the discrimination that currently exists against plans for smaller employers, in our opinion, could go a long way toward encouraging universal coverage in the private pension system.

A second major element of our legislative proposal is a series of changes that we've developed with respect to the integration rules.

Stated as briefly as I can, these changes are oriented toward directing the integration rules to mirror the national retirement income goals. We would set up a graded schedule of integration wherein an integrated plan would close the gap between Social Security and the national retirement income goals in equal measure at each level of compensation.

In closing, I'd like to join with the other individuals who have spoken before me in urging the committee to take the lead, as it has, in developing this policy, and I'd like to thank you for the opportunity to speak today.

[Prepared statement of Robert D. Lebenson follows:]

PREPARED STATEMENT OF ROBERT D. LEBENSON, PRESIDENT, AMERICAN SOCIETY OF PENSION ACTUARIES

The American Society of Pension Actuaries is a national professional society whose 2,000 members provide actuarial, consulting and administrative services to approximately 30% of the qualified retirement plans in the United States. One of the primary purposes of the our Society is to "preserve and enhance the private pension system as part of a cohesive and coherent national retirement income policy."

In the last few years we have seen a proliferation of legislation changing the ground rules under which the private system operates without adequate consideration of the impact of such legislation on the ability of the private retirement system to fulfill its vital role in meeting national retirement goals. We believe the hearings currently being conducted by the Subcommittee on Labor-Management Relations on the need for a national retirement income policy signal a much more constructive, long term approach than the approach that has prevailed in recent years. We applaud the Subcommitee for undertaking these hearings and will endeavor to assist the Subcommittee in any way we can.

Our written testimony is comprised of six parts, described below.

1. A discussion of the material to be covered in the verbal testimony to be presented to the Subcommittee on April 3, 1985. Naturally, considering time constraints on oral testimony, and the possible need to cover matters arising during the hearing itself, the oral testimony will not be identical to that presented here.

2. Summary Policy Statement of the American Society of Pension Actuaries Regarding the Private Pension System.

3. The Answers to a Dozen Important Questions about the Private Pension System.

4. Commentary on the November, 1984 Treasury Tax Proposals Affecting the Private Pension System.

5. Pension Reform Legislation - Discussion Outline

6. Social Security Integration and Vesting Rules For Qualified Retirement Plans - Discussion Outline. It will be observed that the discussion of integration and vesting rules includes a number of illustrative tables. We will be happy to furnish the Subcommittee with other illustrations as desired.

DISCUSSION OF MATERIAL TO BE COVERED IN VERBAL TESTIMONY

HOUSE LABOR SUBCOMMITTEE - APRIL 3, 1985

The American Society of Pension Actuaries, otherwise known as ASPA, is a national society of over 2,000 professionals engaged in all aspects of the operation of retirement programs. The official statement of purpose of ASPA, which was adopted in 1983, reads as follows:

> "The purpose of the American Society of Pension Actuaries is to educate pension actuaries and consultants, and to preserve and enhance the private pension system as part of the development of a cohesive and coherent national retirement income policy."

As you can see from this statement, our Society is on record both as supporting the development of a national retirement income policy and as recognizing the significance of privately sponsored pensions within such a policy framework.

We are especially pleased that the Committee has chosen to hold these hearings, but we are cautious in our optimism about their result. Too frequently over the past ten years various committees, commissions, and other government bodies have been convened to consider the topic of National Retirement Income Policy, only to produce either no results, or results which were subsequently ignored in the legislative process. Too often in the recent past legislation has been hastily conceived, impractically drafted and improperly oriented toward limited or expedient correction of insignificant abuses or achievement of very short-term goals. It is our hope this Committee will not only develop a policy of substance, but also that policy will genuinely be carried forward in a legislative framework which recognizes the long-term nature of retirement income needs and thus is not subject to annual modification.

We believe the two essential components of a national retiement income policy are: first, that it recognize a series of goals for retirement income levels; and second, that it recognize the essential role played by each of the three sources of retirement income, and the interrelationship among sources.

With regard to income goals, it is apparent to us that the minimal goals for retirement income consist of a graded series of replacement ratios similar to those set forth in the President's Commission Report of 1981, within which the highest percentages apply to those on the lowest end of the income scale. However, we do not believe the specific percentages embodied in either the President's Commission Report, or in any other mathematical formula, should in any way be considered as limits upon retirement income. In fact, we feel it is probable the percentage goals set forth in the President's Commission Report are somewhat understated, particularly in their lack of recognition of the ascending costs of medical care which prevail during an individual's post-retirement years, and also because of the changes in the tax status of Social Security benefits.

Once a series of reasonable goals can be established, it is essential that the role of the three components of retirement income be clearly identified and coordinated. We refer, of course, to the classical "3-legged stool": Social Security, private or employer sponsored retirement plans, and individual savings. Within this context, we define employee elective contributions to 401(k) plans as individual savings.

The primary concern of ASPA is the role of private retirement programs within this referenced framework. In connection with the policy aspects concerning private pensions, we believe a number of factors should be recognized.

First, it must be understood that even in the absence of a coherent policy, the fundamental provisions existent in current law have successfully encouraged the voluntary adoption of private plans to a remarkably successful degree. The private pension system today consists of over 800,000 individual plans, which extend coverage to the vast majority of American workers. Studies indicate that by the year 2007, over 71% of all families of retirement age will receive a pension from the private system; and perhaps of more importance, that the average annual benefit received will exceed that provided for them by Social Security. And let there be no mistake about the fact that the coverage extended by the private system does not overwhelmingly benefit those with higher incomes, as has often been suggested, but rather virtually mirrors the wage distribution of the American population. In this connection, we call the Committee's attention to the various statistics which are embodied in the written portion of our testimony.

Second, the private system must be intelligently coordinated with Social Security, such that this coordination relates to the retirement income goals which form the cornerstone of the overall policy. We must emphasize that any such system of coordination recognize the voluntary nature of private pensions; thus the system cannot be successful if it results in excessive cost to plan sponsors. In this connection, we wish to express our basic support for the philosophy of Social Security integration, while at the same time recognizing that its present construction is both outdated and subject to certain limited potential abuses. We wish to make it clear that this structure needs improvement, not elimination.

Third, the policy toward private pensions should place an emphasis on, and give the most favorable treatment to, those programs which provide genuine retirement income. However, this emphasis must be coupled with both a stability in the benefit distribution rules and a flexibility which recognizes the different needs and situations of different individuals. Many of the present rules, with their enforced "cliff retirement", fail to recognize not only the financial requirements of senior citizens, but also their physical and emotional needs as well.

Fourth, the policy must recognize that the private pension system can in no way be replaced by Individual Retirement Accounts, particularly as the IRA program is presently constructed. The nature of that system is in direct opposition to any national series of retirement income goals. Greater employee coverage can be achieved by promoting other savings incentives in lieu of expanded IRAs.

Fifth, the private pension system, and also the other components of retirement income, must be clearly recognized for their long-term nature, which mandates a greater degree of legislative stability than virtually any other matter which is subject to Congressional activity. Among the questions posed in the Committee's announcement of this hearing is "How should a national retirement income policy be implemented?" Our answer to this question can be stated in a single word — SLOWLY.

Finally, and perhaps of greatest current importance, the policy must refute the myth concerning both the nature and the extent of tax expenditures related to private pensions. For example, some would have us believe there is a dollar for dollar loss to Treasury for current deductions and exclusions, whereas studies indicate that after adjustment for interest and inflation the government will eventually collect between

64 and 72 percent of the taxes initially deferred. It is our belief that this myth poses a tremendous threat to the private pension system. We would urge that complete recognition be given to the fact that the private pension tax expenditure is not a measure of its burden upon the taxpayer, but rather a measure of the success of the system.

Our written testimony which has been presented to the Committee contains an outline of legislative recommendations which we believe are a positive and coherent approach toward achieving the goals we have enunciated. We have discussed these proposals with members of the Committee staff and hope to continue to have the opportunity to work with both the Committee staff and with other groups to develop and refine these concepts. We certainly do not believe each of our recommendations is perfect, and we do not believe they should be enacted in any haste. Nevertheless, we believe they should serve as a framework for legislative action in the future, following the adoption of the national retirement income policy we hope the Committee will formulate.

The proposals are too lengthy to be reviewed and to be totally expressed in our oral testimony, but we would like to take a moment to highlight the most significant components which are included.

First there is a series of incentives for small plan formulation, which are similar to those recommended in the past by Senator Jacob Javits. These incentives are primarily directed at plan formulation within the small to mid-sized businesses where lack of coverage is most prevalent.

Second, there is the removal of the legislative discrimination which presently exists against those plans sponsored by smaller businesses. This component, coupled with the incentives contained in the first item, should combine to promote voluntary participation in the private pension system on a nearly universal basis.

Third, there is a restructuring of the current method of Social Security integration. This new structure is oriented toward coordinating the two systems and directing them toward the national retirement income goals. It is also oriented to correct the inequities which potentially can result from the present system, without placing a cost burden upon employers which would be a deterrent to sponsorship of private plans.

Fourth, there is a uniform acceleration of vesting requirements to recognize and serve the needs of the increasingly mobile American work force.

Fifth, there is a simplification and restructuring of a number of rules which limit or govern the distribution of private plan benefits into an improved structure which emphasizes the use of private plans to provide retirement income in a flexible fashion able to satisfy individual needs.

In closing, we would like to urge the Subcommittee, as well as the full Congress, to proceed along a path embodied in the following recommendations:

First, we urge the debate be focused around the framework set forth in the legislative outline which we have presented. It embodies what we believe is a series of positive recommendations directed at national retirement income goals. It has been prepared by a group of professionals concerned about the success of the private pension system and experienced enough to understand how it truly works.

Second, we urge that any legislative activity proceed at a reasoned and deliberate pace, to avoid the piecemeal tinkering of recent years. In particular, we most strongly urge that all measures relating to the private pension system be deleted from any tax simplification or reform being considered by the 99th Congress.

Third, we urge the House Committee on Education and Labor to take the lead in restoring the appropriate jurisdictional balance regarding pensions within the Congress, a balance which prevailed successfully during the passage of ERISA. We also urge that the bipartisan spirit identified with Mr. Erlenborn, and carried forward by Chairman Clay, prevail with respect to all pension legislation. The retirement income security of American citizens is too important to be a political and tax football.

Fourth, we call for an expanded degree of participation by those in the private sector who are concerned with, and understand, both the private pension system and its place within a national retirement income policy.

Finally, we urge Congress to assist the Secretary of Labor in fulfilling his mandate under Section 513 of ERISA by translating into action some of the National Pension Forum recommendations. Specifically, we support the establishment of an Interagency Employee Benefits Council to coordinate pension and welfare benefits information and activities among the various Federal agencies having jurisdiction over pensions. And, we support the appointment of a Presidential Task Force "to study the interrelationship of pension equity and pension cost to both employers and taxpayers." A thorough analysis and review by such a body would go a long way toward settling the issues of single agency and national policy goals.

AMERICAN SOCIETY OF PENSION ACTUARIES

SUMMARY POLICY STATEMENT

REGARDING THE PRIVATE PENSION SYSTEM

1. The private pension system must be acknowledged as an indispensable part of a coherent and cohesive national retirement income policy, together with a healthy Social Security system, and individual savings.

2. The balance between economic incentives and the formation, funding and continuation of private retirement plans for the benefit of the broadest possible class of private sector employees is critical. Accordingly, no modification of current incentives should be allowed without thorough prior analysis and documented, demonstrable assurance that such legislation will not impair that balance. Any such impairment would negatively impact on the interests of the millions of participants and beneficiaries who derive benefits under private retirement plans.

3. In particular, no legislation constructed to accomplish short-term objectives should undermine the private pension system, since it represents such an integral part of long-term policy. This undermining would ultimately exact the greatest penalty from the lowest income group.

4. In comparing the tax cost of the private pension system with its benefits to society, cash flow tax expenditure analyses should be avoided. In these analyses, the expenditure is calculated as current taxes lost (through deductions and exemptions) minus current taxes gained (through taxable pensions). Instead, lifetime expenditure analyses should be used. In these analyses, the expenditure is calculated as current and future taxes lost respecting today's workers minus future taxes gained respecting these same workers. These lifetime analyses must include adjustments for inflation and the time value of money.

5. In appraising the tax cost of the private pension system for deficit impact purposes, cash flow expenditure analyses are inevitable. But these analyses must include realistic projections of taxpayer behavior in the absence of pension plan deductions and exemptions. It is not realistic to assume that if these deductions and exemptions were eliminated, taxpayers would simply pay more taxes. They would seek out alternative tax planning devices. Most of these alternatives are less desirable, socially, than provisions which foster the private pension system, which provides meaningful retirement benefits to millions of Americans.

6. In addition to its social values, the private pension system should be recognized for its indispensable value to the national economy, as both a positive contributor to national savings and a source of capital for continuing economic recovery and vitality.

7. A major problem within the private system is the absence of coverage of many workers. This absence is most prevalent in smaller businesses. Added incentives should be implemented to encourage plan formation, especially within smaller companies.

8. Not only are such added incentives needed, but the discrimination against smaller businesses existent in the present tax system should be ended. National policy should not favor large companies over small businesses — the source of more than 70% of all new employment creation.

9. A coherent national retirement income policy must continue to allow coordination between the benefits from Social Security and those from the private system.

10. Any scheme of "mandatory" private pensions is merely another form of taxation, and is particularly ill-conceived because:

    - It will have the greatest negative impact on the firms with the least resources (which are primarily smaller, newly-formed businesses).

    - It is not directed toward assisting those with the greatest retirement hardships (who are primarily those with chronic problems of unemployment).

11. The inherent long-term nature of the private pension system requires an environment of stability in order to thrive. The constant "tinkering" with the rules in recent years not only causes termination of plans, but discourages the formation of new programs. An atmosphere of uncertainty must be avoided.

12. Increased cooperation between the public and private sectors is necessary to define national retirement income policy goals, and to implement programs to achieve these goals. This cooperation should include enhanced interaction among government, labor, and large business; but especially should dramatically increase the involvement of small business in the process.

AMERICAN SOCIETY OF PENSION ACTUARIES

THE ANSWERS TO A DOZEN IMPORTANT QUESTIONS ABOUT THE PRIVATE PENSION SYSTEM

1. Do private pensions cover enough employees to be meaningful?

There are nearly 800,000 private retirement plans in America, and 59% of all nonagricultural wage and salary workers are covered.

Perhaps of more importance, when the "ERISA work force" (consisting of individuals over age 24 who work at least half the year) is considered, the percentage of coverage increases to nearly 71%.

2. But isn't this coverage mostly slanted to higher income employees?

Of the total ERISA work force, 76% of its members earn up to $25,000 per year, 21% are between $25,000 and $50,000, and 3% are over $50,000. By comparison, 72% of those covered by pensions are in the under $25,000 category. Only 4% of pension covered employees earn over $50,000.

3. Despite these high coverage rates, don't "vesting" rules mean that very few will actually receive any benefits?

Currently, nearly 67% of those covered employees already have a vested right to a future pension.

Studies indicate that by the year 2007, over 71% of all families at retirement age will receive a private pension. And, that average annual benefit will be $9,300, which would be more than the average Social Security pension they will receive.

4. These coverage and vesting figures make it sound like private pensions do not need any more encouragement.

While the system is increasingly successful, there are still nearly 30% of the ERISA work force not covered by any plan. Additionally, the average retiring worker in the future will receive somewhat less (including Social Security) than the average retirement income goals suggested by the President's Commission. Benefits continue to need to be improved, and new plan formation encouraged.

This is especially true among smaller businesses, where because of a special set of rules which actually discourage retirement plans, the coverage percents are lower than the overall averages.

1413 K STREET N.W. • FIFTH FLOOR • WASHINGTON, D.C. 20005 • (202) 737-4360

5. Why can't an expanded Social Security program make up the difference in coverage and benefits?

   Social Security already has enough problems and financial pressures, which are not the subject of this paper. But aside from these, the fact is that Social Security is a system that severely redistributes retirement income, away from middle class citizens. Studies show that the average family with pre-retirement earnings from $20,000 up will receive Social Security benefits of less value than the taxes paid. Expanding Social Security would only magnify this inequity.

6. How about IRA's? Can't they take up the slack?

   IRA's are the most discriminatory form of retirement plan of all, especially compared to the across the board coverage of private pensions. While employers provide the funding for private plans for all income levels, only individuals who can afford IRA's on their own are able to use them.

   Less than 14% of workers earning under $25,000 have IRA's compared with more than 67% for those earning above $50,000.

7. But can the Government afford to encourage more private pensions? Aren't employee benefits which erode the tax base a tremendous share of total compensation already?

   While it's true that total employee benefits represent 32.5% of overall compensation, this figure includes both mandatory payments (such as Social Security taxes) and also fully-taxable benefits (such as vacation pay).

   In fact, only 9% out of that overall figure represents benefits which are tax favored in any way. And just a little over half of this amount consists of totally tax-free benefits; the remainder are benefits which are tax-deferred.

8. Still, isn't it true that the "tax expenditure" for pensions is out of control, and represents the largest single loss in revenues?

   The tax expenditure calculated for pensions has accelerated to a rate of $56.3 billion in the 1985 Federal Budget. However, three significant factors should be recognized, which suggest this figure is far less reliable or meaningful than it appears.

   a. For the first time in fiscal 1984, the tax expenditure relating to pensions included amounts for governmental retirement programs. In that year alone, the total budgetary tax expenditure increased by over 75% from 1983, when only private plans were included.

   b. The magnitude of the figure respecting private plans is a direct reflection of their soundly funded position, resulting from the policies and encouragement of ERISA. By comparison, if private pensions were as poorly funded as the Civil Service Retirement System, tax expenditures would drop to only $12.0 billion.

c. Most importantly, the tax expenditure calculations relating to pensions ignore the fact that the tax benefits involved are deferrals, not outright losses. Studies indicate that after adjustment for interest and inflation the government will eventually collect between 64 and 72 percent of the taxes initially deferred.

9. Despite the broad coverage levels of private plans, don't these tax benefits primarily help the weathly, whose marginal tax rates are higher?

Just the opposite is true. The tax deferral on pension contributions and earnings causes the average worker earning under $10,000 to save 17.5% in current tax payments. By contrast, the savings for workers over $50,000 is only 7.6%. And for the highest income range (over $200,000) the tax reduction is only 3.3%.

To look at it another way, over 74% of the total tax savings are for the benefit of employees earning up to $50,000, while only 2.1% goes to those in the highest income range.

10. Nevertheless, doesn't it make sense to make the system even fairer by further reducing the maximum benefits that the highest earners can enjoy?

Reduced limits do not only affect high income employees. Rather, because of inflation, they have a relatively constant impact on workers at all income levels.

The TEFRA benefit reductions enacted in 1982 impacted upon 9.3% of those then earning over $50,000. However, they will also cause 7.2% of workers under $10,000 to have their pensions reduced.

11. The private pension system certainly seems to provide valuable and equitable security to a wide majority of American workers. Are there other reasons why its continued development should be encouraged by a favorable tax structure?

Essentially, because it's a good buy.

Total retirement plan assets currently exceed 1 trillion dollars. Private pension funds are the largest single institutional investor in the American economy (in fact, are over 60% greater than the next largest investment source). Clearly, the private pension system is a vital component of continued economic growth.

Additionally, the security provided by pensions and other major employee benefits has enriched the lives of the vast majority of our citizens, and simultaneously reduced their dependence upon expanded Federal programs.

Obviously, it is impossible to measure statistically the precise impact that either the expanded availability of capital, or the enhanced worker productivity, have had upon the nation's economy. However, it is certainly a reasonable judgment that these factors have generated a net expansion of the tax base, far exceeding the "losses" that are presently being publicized.

12. President Reagan has promised that Social Security benefits will not be reduced. If this is true, won't the retirement income needs of our citizens be taken care of?

From the facts cited in several of the earlier sections, it is clear that private pensions will be the largest source of retirement income, covering the great majority of workers.

Therefore, it would be meaningless for these workers to rely upon no Social Security reductions (if in fact that were even possible) as a basis for their retirement income security, if at the same time there were any diminishment in their private pension benefits.

For the average American, any lesser support of private pensions is equivalent to a cut in Social Security.

Sources

Q1. Employee Benefit Research Institute, EBRI Issue Brief #33, August, 1984.

Q2. Ibid

Q3. ICF Incorporated, Future Retirement Benefits Under Employer Retirement Plans, June, 1984.

Q4. Presidents Commission on Pension Policy, Toward a National Retirement Income Policy, February, 1981.

Q5. Anthony Pellechio and Gordon Goodfellow, Individual Gains and Losses from Social Security Before and After the 1983 Amendments, Fall, 1983.

Q6. See Q1.

Q7. U.S. Chamber of Commerce, Employee Benefits 1982, pp. 11 and 28.

Q8. a) Office of Management and Budget, Washington, D.C.
Special Analysis G of the Budget of the United States Government for Fiscal Years, 1981 to 1985.

b) Dr. Sophie M. Korczyk, Retirement Security and Tax Policy, pp. 60-61.

c) Ibid, pp. 51-57.

Q9. Office of the Secretary of the Treasury, Office of Tax Analysis, September 28, 1982.

Q10. See Q8 (b), pp. 91-93.

Q11. U.S. Department of Commerce, Bureau of the Census, Statistical Abstract of the United States, 1984.

AMERICAN SOCIETY OF PENSION ACTUARIES

COMMENTARY ON NOVEMBER, 1984 TREASURY TAX PROPOSALS AFFECTING THE PRIVATE PENSION SYSTEM

The American Society of Pension Actuaries is, in the main, pleased with the attitude toward the private pension system reflected in the recent Treasury proposals for tax reform. The recognition that the private pension system serves an important social purpose and should retain its present tax status is a welcome conclusion which we heartily endorse.

However, we do take issue with the changes which are proposed to the private pension system. We take issue, not so much because we oppose all of the Treasury proposals affecting pensions on their merits, but because we are strongly opposed to a policy which approaches the private pension system as an area where piecemeal legislation in the name of tax reform can be accomplished without damage.

There is a strong sense in this country, which is reflected in the Treasury conclusion that the private pension system retain its present tax status, that the Social Security system should not be relied upon totally for the long term security of our citizens. The private pension system is the vehicle which has developed as a supplement to Social Security, and many believe the private pension system may be the mainstay for the retirement income security and protection of our citizens in future years. Legislation which discourages the adoption and maintenance of such programs is counterproductive to the long range needs of our citizens, and could lead to a more serious problem for our senior citizens, and thus for our society.

There is virtually no revenue gain to be realized from the Treasury's proposal relating to the private pension system, and in fact a significant revenue loss will occur if the individual retirement account limitation is raised.

Since the Treasury has concluded that present deductions for pension and profit sharing plans should be retained, as evidenced by the fact that there is no significant revenue gain generated from the changes proposed by the Treasury to the private pension system, we submit that it is inappropriate to mix pension legislation with tax reform, especially in light of the significant changes already imposed on the private pension system by recent changes in law.

The private pension system is not a monolith that can respond to change, good or bad, without difficulty. The private pension system is a series of 800,000 or more individually maintained programs, and any change in the system must be explained in one way or another to the sponsors of each of those programs. In addition, any change requiring changes in plan documents must be incorporated by amendment, adding an additional cost to the implementation of the change. Since most plan adminsitration is computer-assisted, the programs written to administer the plans must be revised to conform to whatever administrative differences result. All plan participants affected by a change must be notified in one fashion or another that the change exists, and in many instances the law requires that the participant and his or her beneficiaries receive a full explanation of the effect of the change. Regulations are rarely issued less than a year after the legislative change, and many regulations, even those under the 1974 pension law, ERISA, are still not written. This causes further uncertainty and confusion in the operation of these programs. As a result, small changes in pension tax law create new plan administration costs (which are deductible and drain Treasury revenue) and uncertainty.

During the last few years, Congress has tinkered with the private pension system through the Tax Equity and Fiscal Responsibility Act (TEFRA), the Deficit Reduction Act (DEFRA), and the Retirement Equity Act (REA). Whatever the intent of these laws, their effect upon the private pension system as a viable supplement to Social Security has been negative. The additional costs attendant to compliance, which includes all of the expenses inherent in the education, communication and amendment process on eight hundred thousand separate programs, their sponsors and participants must be dealt with. Such costs are a drain on the private pension system and divert assets otherwise available to provide benefits.

In addition, the uncertainty as to the future treatment of the private pension system, most especially with reference to the tax law, leads to a delay in the implementation of new plans or modifications to existing programs.

To summarize our response to the Treasury proposals as they affect the private pension system:

1. We applaud the Treasury's recognition that the private pension system is a valuable social program which must be encouraged and supported under our tax system.

2. We object to the specific changes contained in the Treasury proposals affecting the private pension system. We object to these proposals on the basis that they constitute still further tinkering with a system that has suffered much tinkering at significant expense over the last few years, and is still uncertain as to the impact of the legislative changes made in the last three years. The proposed changes will raise no material revenue; work no simplification; create added confusion; and discourage the formation of new plans and the maintenance of existing plans.

3. We object to the policy reflected in TEFRA and DEFRA, and continued to an extent in the Treasury proposals, that recognizes a distinction in the tax law between the small plan and the large plan. The private pension system can only accomplish its purpose if there is incentive for all businesses, large and small, to establish pension and profit sharing programs. Discriminatory legislation prevents smaller businesses from establishing and/or maintaining such programs. The distinction, first established in TEFRA, must be abolished if the private pension system is to be truly healthy.

4. The private pension system is extraordinarily important to the well-being of our society. It provided the only logical approach to supplemental retirement benefits for our senior citizens. This is the wrong time, and the wrong forum, for further tinkering with the private pension system.

Because we recognize that there is concern with reference to many aspects of the system in operation, reflected not only by the legislative changes which have occurred in the last few years, but also by proposals which transcend the limited tinkering reflected in the Treasury proposals, we as an organization stand ready to work with those who feel legitimate concern for the manner in which the system is operating, and will work together with Congress, the Labor Department, and the Treasury Department and the PBGC to strengthen the private pension system.

AMERICAN SOCIETY OF PENSION ACTUARIES

PENSION REFORM LEGISLATION

DISCUSSION OUTLINE

I. Objectives

A. Create incentives for new plan formation and plan upgrade, to improve coverage percentages.

B. Improve standards for non-discrimination; enhanced coverage coupled with added protection against integration and vesting "abuses".

C. Extend concept of "parity" within business form (corporate/non-corporate) to parity within business size.

D. Focus coverage incentives and anti-discrimination rules toward rational retirement income goals.

E. Promote utilization of qualified plans for the primary purpose of providing lifetime retirement income.

II. Premises and Assumptions

A. Legislation to be effective no earlier than 1988; preferably, full effect no less than two years after enactment. Stability must be restored to system.

B. Suggestions for legislation are being presented as a coherent package, not to be adopted piece-meal (i.e. do not enact restrictions but ignore added incentives).

C. Treasury (or similar) tax proposal will be enacted in 1985/86, but without retirement savings elements. (Note: Those suggestions below labeled * might not be acceptable absent this.)

D. Legislation must recognize the "real world" relative to incentives and motivation for plan formation and improvement. "Value judgments" concerning employers' attitudes should be avoided.

E. Differences in treatment between small and large plans must be eliminated. In fact, new plan formation incentives must be oriented toward smaller firms, where coverage is most lacking.

III. Suggestions for Legislation

A. Ecomomic Factors: Incentives/Investments/Balanced Revenues

1. Tax or other economic credit (on top of deduction) for new plan formation, or non-mandatory benefit upgrade.

    a. Review Javits plan (circa 1979).

    b. Perhaps special "short-term push" (5 years).

2. Possible taxation on "excess" trust assets: See Asset Reversion section (E1 below).

B. Liberalize Limiations To Create Further Incentives, Especially Respecting Small Plans

1. Eliminate Top Heavy distinction and all related rules.

2. Liberalize and simplify Section 415 limits.

    a. Increase Defined Benefit dollar limit to $120,000 per year for ages 62-65.

        i. Actuarial adjustment at other ages;
        ii. $75,000 "floor" repealed.

    b. Continue Defined Contribution limit at $30,000 (note: This brings the dollar limit relationship into line with existing percentage limit relationships).

    c. Repeal two plan restrictions ("1.25 rules" - Section 415(e)) for plans of all sizes.

*3. Couple with surtax on annual retirement income over $150,000 (vs. Treasury proposal).

    a. Do not apply retroactively.

    b. Dollar amount dependent on retirement age: i.e. 125% of 415 Defined Benefit dollar limit at every age.

4. Implement small business loan exemption

    a. Terms proposed to D.O.L. by Arthur Anderson & Co.

C. Modify, Improve, and Simplify Rules Regarding Discrimination

1. Social Security Integration

    a. Minimum objective: correct potential for abuse in present system, e.g. denial of any accrual for lowest paid, excessive credit for Social Security benefits by one employer.

b. Optimal objective: create relationship with total retirement income goals, oriented to graduated replacement ratios.

c. Additionally:

   i. Simplify the rules;
   ii. Recognize the changes in Social Security; retirement ages, benefit calculations;
   iii. Create motivation for employer to upgrade benefit levels;
   iv. Reverse the current bias against cost-of-living adjustments, joint and survivor benefits.

d. One possible revised approach for Defined Benefit Plans is discussed in attachment.

e. Note: Revisions must be accompanied by Top Heavy repeal.

2. Vesting

   a. Uniform acceleration for all plans.

   b. Continue to have three alternatives.

      i. 5 year cliff
      ii. Graded over 8 to 10 years;
      iii. 3 year cliff with 3 year eligibility.

   c. Protection temporarily needed for participants in plans that were Top Heavy (before repeal).

   d. Simplification of certain ERISA/REA rules:

      i. Clarify several aspects of subsidized early retirement benefits.
      ii. Permit sponsors to satisfy spousal protection obligations via group (or other) life insurance plans.
      iii. Clarify notice and election rules relative to spousal pre-retirement survivor benefits.

   e. Extension of spousal protection requirements to IRAs.

D. Focus Qualified Retirement Plans Toward Providing Retirement Income, With a Consistent Set of Rules

1. Apply single set of rules with respect to all types of tax-favored plans (relate to Treasury proposal).

*2. Modify or eliminate 10 year forward averaging (question with respect to transitional allowances). Also eliminate

   a. Special 3 year recovery rule.

   b. Special distribution rules for employer securities.

3. Continue or restore favorable tax treatment for special distributions

   a. 10 year averaging should remain available for death payments.

   b. Restore exclusion from estate taxes for death benefits (reason: motivation for plan formation).

4. Excise tax on "early" plan distributions

   a. Age 59 1/2 is possibly too arbitrary. Possibly a retirement test should be substituted.

   b. Exception should be made for genuine retirement income, i.e. lifetime or joint/survivor annuity.

   c. To avoid excessive use of (b), perhaps apply excise tax if other earned income is above a stated floor.

5. Minimum distribution rules

   a. Age 70 1/2 too arbitrary if retirement not reached.

   b. Suggestions:

      1. Count actual earned income from plan sponsor as part of minimum distribution.

      2. Consider replacing 70 1/2 by Social Security retirement age plus 5 years.

6. Portability: Comments which follow relate to contents of Ferraro VIP draft.

   a. $7,000 level too arbitrary; should be scaled to other factors.

   b. Appears to be no incentive for employee to choose PPA vs. normal IRA rollover.

   c. Why exclude Profit Sharing/401(k) plans?

E. Modifications relating to funding policy (defined benefit plans)

1. Asset reversion upon defined benefit plan termination

   a. Establish a corridor between minimum and maximum asset balances. Permit asset reversion even while a plan is ongoing, to the extent asset balances do not fall below the low end of the corridor.

   b. Establish graded PBGC premiums which are highest when assets are at the low end of the corridor and reach zero when assets reach the high end of the corridor.

   - c. Acknowledge that there is nothing wrong with reversions from an ongoing plan, providing remaining balances do not fall below a critical level - the minimum asset balance. To the extent insolvency risks increase as assets fall to this minimum assets balance, increased PBGC premiums will compensate.

   - d. Avoid any automatic tax on asset reversions. This would simply encourage restrictive funding policies.

2. Excise tax on excess plan contributions (Treasury proposal)

   - a. Preferable alternative to plan disqualification.

   - b. Inclusion of restrictions on I.R.S. unilateral authority to judge actuarial assumptions "unreasonable"; reaffirm prerogatives of Enrolled Actuaries.

3. Repeal I.R.C. Section 404(j) and related I.R.S. regulations prohibiting the deduction of contributions based on actuarial projections of dollar limitations.

F. Individual Retirement Savings - 401(k) vs. IRA

1. Alternative to current Treasury proposals.

   - a. No increases to present IRA limits.

   - b. Retain 401(k), but place a lower dollar limit (perhaps $15,000) on allocation to any individual.

   - c. Reduce any individual's IRA limit by any allocation under a 401(k) plan.

   - d. Index both 401(k) and IRA limits to inflation.

2. Severely restrict or eliminate in-service withdrawals from 401(k) plans; uniform distribution rules are to apply to all programs (see section D above).

3. Other possible considerations.

   - a. Remove or modify requirement for current/retained profit for 401(k) salary reductions.

   - b. Reduction in an employee's IRA limit by employer's contribution to a 401(k) plan, coupled with enhancement of spousal IRA limits.

G. Administrative and Other Matters

1. Legislative moratorium following passage of proposed law.

   - a. Technical corrections excepted

   b. Mandatory regulatory activity

2. Establish permanent Advisory Board on retirement income goals, comprised primarily of the private sector members.

   a. Business and professions - including actuaries.

   b. Monitor interaction of changing goals with integration rules, etc.

   c. Monitor success in achieving inflationary protection.

3. Other issues - ERISA Administration and National Pension Forum recommendations.

SOCIAL SECURITY INTEGRATION
AND
VESTING RULES
FOR
QUALIFIED RETIREMENT PLANS

A DISCUSSION OUTLINE

I. PROPOSALS RESPECTING NEW RULES

A. INTRODUCTION AND OVERVIEW

This is principally a discussion outline of possible revisions in vesting and integration rules for qualified retirement plans. However, any rational discussion of these topics leads inevitably to a discussion of national retirement income goals in general.

It seems reasonable that a consensus on rules will be reached more easily if there is a consensus first on principles to be followed in formulating these rules. In other words, before we agree on rules, we must agree on what it is we are trying to accomplish. Once there is an agreement respecting principles, each proposed rule can be evaluated from the standpoint of whether it is consistent with the principles.

Part C is a list of suggested principles to be followed in developing national goals for retirement income. One of our problems throughout the last ten years of legislative backing and filling is that these goals are not adequately defined.

Once national retirement income goals are established, it becomes possible to develop rules for private plans. Part D of this discussion is a list of suggested principles for development of these rules.

Part E illustrates a set of rules which might follow from the principles suggested in Parts C and D. The focus in Part E is entirely on defined benefit plans. Additional work would be required, to translate these rules into ones appropriate for defined contribution plans.

The reader who has been made weary by the high frequency of legislative changes may not view the major changes illustrated at Part E with unmitigated joy. Unfortunately, in failing to define our goals, we may have drifted so far off course that major restructuring is inevitable. Nevertheless, a rational set of transition rules will be critical. For example, the sponsor of a top-heavy plan who has already satisfied top-heavy rules might be permitted to stay with these rules - indefinitely, if he wishes. He might thereby be excused from compliance with most of the new rules.

B. INTEGRATION RULES VS. §415 LIMITS

Certain principles proposed in Parts C and D may lead to conflicts with existing §415 limitations.

For example, we suggest that inflation be acknowledged as a fact of life which must be accommodated. However, we also suggest that an employer uneasy over casting his program using an inflation adjusted benefit should not be required to do so. It follows that this employer should be encouraged to provide greater flat-dollar benefits. The optimal flat-dollar benefit would be equivalent in value to an inflation-protected benefit which satisfies the national goal.

For a second example, we suggest that no single industry or firm should be forced into a "normal" retirement age identical to a "national norm." A different normal retirement age does not necessarily mean that different replacement ratios are appropriate.

In both of these examples, the integration rules which might be developed could be inconsistent with §415 rules.

Integration and §415 are both highly charged and controversial issues. The first involves concern that the private system might disenfranchise rank-and-file workers. The second involves revenue concern and concern that we are being too generous to our "fat cats." Sensible rule-making on either issue will be difficult. Combining the two might make things impossible.

For this reason, we suggest separate treatment of the issues. As a procedural matter, we suggest that revision of §415 be considered "off limits" in the discussion of integration rules.

C. SUGGESTED PRINCIPLES FOR NATIONAL GOALS ON INSTITUTIONALLY PROVIDED RETIREMENT INCOME

1) Goals should be expressed in terms of wage replacement ratios which are higher for low-wage workers, lower for high-wage workers, and which grade smoothly in between.

2) Percentages similar to those developed by the 1978 President's Commission on Pension Policy constitute an excellent starting point. However, note must be made of two developments which have occurred since the President's Commission completed its work. First, social security benefits, formerly non-taxable in all cases, are now partially taxable in certain cases. Second, retired people are being asked increasingly to make their own provision for health care. Formerly, Medicare handled the lion's share of the job. The share now handled by Medicare is becoming progressively smaller. These developments suggest a need for upward adjustments in the percentages.

3) Goals for institutionally provided retirement income and goals for retirement income attributable to voluntary personal savings should be defined separately. Goals in the latter category will need to be defined more broadly to reflect different individual needs. Nevertheless, the institutional goals should be established with an acknowledgment that personal saving for retirement is expected of every citizen.

4) "Bend points," or wage levels above which replacement ratio goals decrease, should be indexed to inflation.

5) The need for protection from inflation after retirement should be recognized explicitly.

    a) This is not the same as saying that post-retirement indexation should be made mandatory.

    b) Consideration should be given to requiring that either a cost-of-living adjusted benefit or a "ramp annuity" must be offered as an optional benefit. The ramp annuity would provide benefits which increase by a uniform percentage annually after retirement. The option could be structured so that subsidization is not required.

6) Goals on retirement age should be indexed to continuing improvements in longevity.

   a) The ERISA definition of normal retirement age conflicts directly with this principle. It also conflicts with the social security program which will be grading to age 67 as the pivotal retirement age.

   b) Ideally, the age embedded in any retirement income statute will be indexed automatically to improving longevity.

7) Goals on retirement age should not force individual industries or firms into a national norm. The need for flexibility is especially pronounced with industries experiencing unusually rapid technological change. In some cases, the only humane approach is a liberal set of "early" retirement rules.

D. SUGGESTED PRINCIPLES FOR SOCIAL SECURITY INTEGRATION AND OTHER NON-DISCRIMINATION RULES

1) Rules should be related explicitly to our national goals for institutionally provided retirement income. This institutionally provided income includes benefits from the mandatory plan (social security) and those from voluntary plans (private retirement plans).

   a) For example, if our income replacement goal at a given wage level is 75%, and social security replaces 45%, the target for the private plan should simply be the difference: 30%.

2) Workers who experience job changes should not suffer substantial setbacks in their progress towards meaningful retirement income. This is an especially critical imperative wherever job changes are not totally voluntary.

   a) This principle is generally satisfied by plans which satisfy top-heavy vesting requirements. It would come close to being satisfied by a 5-year cliff vesting requirement.

   b) For terminations before satisfaction of the 3- or 5-year rule, consideration should be given to a distinction between voluntary and involuntary termination. This has been a workable distinction in the administration of most unemployment compensation laws. It was used fairly commonly in retirement plans before ERISA.

3) The portion of the career retirement burden borne through any one job should be generally related to the portion of the worker's career spent at that job. It should also be generally related to the portion of the worker's career earnings (in real terms) achieved through that job.

   a) One implication of this principle is that employers should be permitted to provide for accruals which reflect long periods of total employment. For example, when a worker holds a particular job throughout just his final 10 years before retirement, it should not be expected that this job will produce more than about a quarter of his retirement income.

b) Another implication is that early career accruals should be adjusted to reflect later inflation. If a worker stays at a single job in a final pay plan, this happens automatically.

c) Consideration should be given to vested benefits which are indexed to inflation occurring between date of employment termination and retirement date.

d) Many in the private sector will oppose such indexation vigorously. An alternative should be made available. The alternative might be a fixed inflation assumption which can be applied with finality at time of employment termination.

e) Steps toward indexation must reflect the voluntary nature of the private system. Requirements must not be so burdensome that sponsors conclude the better option is to abandon their plans.

f) The front-loaded defined benefit top-heavy minimum violates this third principle seriously in cases of short service periods late in a worker's career. The same front-loaded minimum approaches the right answer for the wrong reason in cases of short service periods early in a worker's career. Here, the overkill of the 10-year accrual period tends to offset the shortfall of the absence of inflation adjustment.

4) Principle 3 involves allocation of the retirement burden among the various jobs held by a worker throughout his career. That principle should not be frustrated by a worker's decision to spend part of his career outside of social security covered employment.

a) Current step-rate integration rules satisfy principle 4. Current offset rules do not.

b) This principle would be satisfied for offset plans if Rev. Rul. 84-45 were rewritten to include rules on estimating social security without giving the participant the right to challenge the estimate. Every worker would simply be deemed to have a social security benefit estimated under a prescribed set of rules.

5) The method for integration with a mandatory benefit should not be affected by whether that benefit is "worker financed" or "employer financed." In a mandatory plan, there is no basis for distinction. As long as financing is through a payroll tax, the entire mandatory plan cost is an employment cost to the employer. The worker's current compensation is net after the same total cost.

a) Clearly, current integration rules violate this principle. The permissible offset should be 100%, not 83-1/3% of the worker's primary benefit. The 83-1/3% offset may come close to the right answers in many cases. But, like the defined benefit top-heavy minimum, it works, when it does work, by accident. Our failure to permit full offset tends to balance out our failure to define appropriate total retirement income goals for lower-income workers.

6) Questions of integration with mandatory retirement benefits should be separated completely from questions of integration with mandatory death and disability benefits. The private retirement plan should not "take credit" for the existence of these other mandatory benefits. Likewise, the sponsor of the private plan should not be penalized because he maintains integrated death and disability benefits at the same time he integrates his retirement program.

    a) Welfare benefit legislation of the 1984 Tax Reform Act introduces a serious violation of this principle. We should define and seek to achieve our goals in retirement income, disability income, and death benefits. We should not permit ourselves to be distracted by the fact that a single mandatory program (social security) happens to provide protection in all three areas.

    b) Part of the rationale underlying current integration rules is that total benefits are equivalent to 150% of primary benefits. To the extent total benefits include death and disability benefits, this rationale violates principle 6.

7) There should be an incentive for employers to voluntarily close the gap between mandatory benefits and our national goals. The incentive should discourage any attempt to close the gap more completely at high income levels than at lower ones. This rule should apply to comparisons between any two income levels. To state the rule more rigorously, we should discourage gap closing at any level which is more complete than gap closing at any lower level.

    a) The concept is that there is a gap-closing objective at every wage level. This objective is the amount by which the social security replacement ratio falls short of our goal for the total institutional replacement ratio. An employer may be given incentives to fill any portion of this gap at any level. However, whatever portion applies at any level should be no greater than the portion at any lower level.

    b) For example, suppose the voluntary private plan gap-closing objective for rank and file employee A is a 40% benefit, and for executive B is a 50% benefit. The employer may provide 25% for executive B (half of the 50% gap-closing objective). However, he must then provide at least 20% for rank-and-file employee A (half of the 40% gap-closing objective).

    c) Existing integration rules violate this principle most clearly when they permit excess-only plans. Here, we are permitting the voluntary plan to approach our objectives for higher-paid workers, without doing a thing for those paid less.

8) There should be incentives which encourage even the most modest voluntary effort to close the gap. No matter how little or how much the gap has been closed, there should be incentives to complete the job.

a) The defined benefit top-heavy minimums seriously violate principle 8. Under the top-heavy rules, one cannot have any defined benefit plan unless one provides the full top-heavy minimum. Then, once this minimum is provided, there is not necessarily any incentive to do more for rank-and-file employees.

9) In general, national goals should be stated in terms of pensions payable for life. If the private plan sponsor wishes to incorporate features such as a 120-month minimum payment guarantee, appropriate adjustment should be made. However, an exception should be considered for spousal death benefits.

a) This principle is consistent with current integration law - except for the exception.

b) The exception has a parallel in §415 limits. There, the limits need not be adjusted to reflect the existence of a qualified joint and survivor benefit.

E. AN ILLUSTRATION

1) There will be a table of target institutional plan replacement ratios related to annual pay. The table might take this form:

Annual Pay	Target Ratio
up to 10,000	85%
30,000 - or over	65%
intermediate levels (between 10,000 and 30,000)	ratio is determined by straight line interpolation (See Selected Target Ratios)

SELECTED TARGET RATIOS

Annual Pay	Target Ratio
$10,000 (or less)	85%
12,000	83
14,000	81
17,000	78
20,000	75
25,000	70
30,000 (or less)	65

2) All dollar amounts in the table will be indexed for cost-of-living changes occurring between now and the date the ratios are applied.

3) Ratios in the table are based on a life annuity with post-retirement cost-of-living adjustments. For a different form, the percentages are adjusted to offset the differences. For example, if the normal form does not incorporate a cost-of-living adjustment, each percentage might be half again as great.

4) Ratios and bend points in the table are based on a final-pay plan, using pay averaged over the highest three years. Other approaches, such as career-pay plans, will be permitted. But, there will be appropriate adjustments to the ratios and bend points.

5) A plan may establish any desired "gap-closing objective" (G.C.O.). A participant's full projected benefit from the plan is determined in these steps:

   a) Multiply his pay by his target ratio.

   b) SUBTRACT 100% OF HIS PRIMARY SOCIAL SECURITY BENEFIT.

   c) Multiply the balance by the G.C.O.

6) A plan may establish any desired number of years of service as the requirement to be entitled to the full projected benefit. For retirement with less than this plan-established maximum, the full projected benefit is proportionately reduced.

7) The plan may not employ a variation which produces a G.C.O. for an employee which is higher than the G.C.O. for any similarly situated lower-paid employee. Subject to this constraint, any desired variation is permissible.

8) An indexed accrued benefit rule applies. Under this rule, the accrued benefit for a participant terminating before normal retirement age is calculated on a fractional years/years basis. The numerator is actual years of service. The denominator is expected years to normal retirement age. Then, the accrued benefit is subject to whichever of these rules is adopted by the plan sponsor:

   a) Floating Indexation: The benefit is indexed to CPI changes between age at employment termination and normal retirement age.

   b) Fixed Indexation: The benefit is multiplied by $(1.05)^n$, where n equals years from employment termination to normal retirement age.

II. TRIAL CALCULATIONS

A. OVERVIEW

Our trial calculations include two tables. Table 1 shows the operation of various plans for participants who retire from the plan at "normal" retirement age. We have selected age 67 as "normal." We do this partly because age 67 will eventually become the normal social security retirement age. Table 1 illustrates three plan formats: A, B, and C. Within each format, we show three levels of benefits.

Table 2 shows certain of these same plans in operation for participants who leave long before reaching normal retirement age. Table 2 illustrates only two formats: A and B.

B. THE ILLUSTRATED PLANS

1) The "A" Plans - Explicit Reflection of Proposed Principles

These plans follow the format illustrated at Part E of Section I.

- Plan A-1 involves a G.C.O. of 1.00.
- Plan A-2 involves a G.C.O. of .35.
- Plan A-3 involves a G.C.O. of .65.

2) The "B" Plans - Current Law - Top-Heavy

These plans incorporate the maximum integration permitted under current law. In all cases, regardless of service, the offset is 83-1/3% of the social security primary insurance amount. These plans are deemed top-heavy. They incorporate the TEFRA defined benefit top-heavy minimum, as if it had always existed.

- Plan B-1 involves a gross benefit of 67%.
- Plan B-2 reduces this gross to 50%.
- Plan B-3 changes it to 58%.

3) The "C" Plans - Current Law - Non-Top-Heavy

These plans follow the "B" format except that they omit the TEFRA minimum. They involve the same gross benefit as the B plans.

4) Selecting the Percentages

The G.C.O. for Plan A-1, 1.00, assumes that the sponsor has decided to go as far as national policy contemplates. Some observers will question the degree of liberality in Plan A-1, if this is to be regarded as the "ultimate." It should be remembered that indexation for inflation after retirement is contemplated as an element of national policy. The sponsor who prefers not to underwrite post-retirement indexation will be meeting higher target ratios if he wishes to achieve this "ultimate" degree of liberality.

The G.C.O. for Plan A-2, .35, may be about as modest a level as makes sense if the sponsor wants any plan at all. We do not, however, recommend establishing any minimum floor.

The G.C.O. for Plan A-3, .65, is simply an in-between illustration.

Percentages for the "B" and "C" Plans have been selected so that, where possible, benefits under each plan will equal benefits under the analogous "A" plan for a specified hypothetical worker. The specified worker is one who retires at age 67 with 40 years of service and a final pay rate of $20,000.

C. ASSUMPTIONS AND EXPLANATION OF TERMS

1) In all cases, the pay amount shown is final pay immediately before retirement or termination of employment. The worker is assumed to have reached this level through annual pay increases. Each year's percentage increase is assumed to be the same as the year's percentage increase in the national average wage calculated for social security indexation purposes.

2) The worker is assumed to have reached normal retirement age (Table 1) or age at employment termination (Table 2) in 1985.

3) In general, all plans base their gross percentages on high three-year average pay. All require 40 years of employment for realization of the maximum benefit. All use a normal retirement age of 67. The B plans provide the TEFRA top-heavy minimum, as if it had always existed. This benefit is based on high five-year average pay.

4) Because normal retirement age is 67, the top-heavy minimum must be actuarially increased. This increase has been based on UP 84, 6½%, with benefit of survivorship. The minimum has been converted to a cost-of-living adjusted form on the basis of these same assumptions and an inflation rate of 4½%.

5) Where employment termination precedes normal retirement age (Table 2), inflation between date of termination and normal retirement age is assumed to occur at 4½%. The FICA base is assumed to increase at 5%.

6) The fractional rule is assumed to apply to accrued benefits in all cases where termination precedes normal retirement age.

7) The column captioned "Attributable Social Security Benefit" is based on the worker's old age benefit. In Table 1, for 40 years of employment, the entire benefit is deemed "attributable." For 25 years, the attributable fraction is 25/40. For 15, it is 15/40, and 10, it is 10/40. In table 2, the attributable benefit is deemed to "accrue" as if the fractional accrual rule will apply to it. This means that for starting age 17, the attributable social security benefit is deemed to accrue at 1/50 per year.

8) Variances reflect the difference between the benefit shown and the comparable "A" plan benefit. Variances are expressed as percentages of the "A" plan benefit. The assumption is that the "A" plan exactly reflects national objectives.

9) The two-column caption "Percents" expresses benefit as percentages of final pay. The column captioned "PP" reflects just the private plan benefit. The one captioned "Tot" reflects the private plan and attributable social security combined. In Table 2, these percentages reflect pay inflated to normal retirement date (NRD).

D. OBSERVATIONS

These observations are based on the assumption that the rules set down in Part E of Section I properly reflect national objectives. Parenthetically, we emphasize, once again, the importance of reaching a consensus on these objectives before any set of rules is seriously considered.

Based on this assumption, the A plans must be acknowledged as exactly appropriate - they follow the Section I, Part E, rules explicitly. It follows that variances displayed for the B and C plans are important measures of the appropriateness of these plans.

Looking at Table 1, our first observation is that existing law is about as irrational a set of rules as one might possibly imagine.

This irrationality reaches its zenith in the top-heavy mode with modest plans covering lower-paid employees who work for brief periods just before normal retirement age. See Table 1, Plan B-2, line 4. We are telling this sponsor that because we designed imperfect rules, he will have to exceed his target in some cases by more than 500%! The message of current law is clear: if you are top-heavy, either avoid adopting a qualified defined benefit pension plan, or avoid hiring older workers.

The same generalizations are possible with Table 2. Existing top-heavy minimums are simply not the right answer to the problem of the short-service employee. They produce gross overkill where the short service occurs at the end of the worker's career. They often produce shortfall where the short service occurs earlier.

Mr. CLAY. Well, we certainly want to thank you for your testimony.

Mr. Fay, in your written testimony, you speak of the employees who participate in the retirement benefit plans, and you talk about plans covering the broad range of the work force and not just limited to the higher paid employees.

You even mention that, among employees with vested pension rights, 70 percent earn less than $25,000, and of employees with health insurance, 80 percent earn less than $25,000.

Of course that's true, but, at the same time, only about 50 percent of the workers are covered by these plans. So I have a question for all three of you, if you would care to respond.

How can we broaden participation of lower-income workers in the private pension system and increase the likelihood of their ever receiving those benefits?

Mr. FAY. Let me respond first, if I may.

First, as has been said earlier, the private pension system is a maturing system. So I think you will see a steady, healthy trend of better participation and better benefits.

For example, on the issue of women and pension plans, I was privileged to attend a private briefing with others of a study being done by the Department of Health and Human Resources, and it showed remarkable improvements in women, because what has happened is that women are now professionals, being given certain kinds of jobs, and once you become a more permanent part of the workforce, the private pension system works.

So, first, I'm saying that it's already taking care of that problem.

Second, I certainly would concur with the recommendation of some sort of incentives for the smaller employers, because that's where the coverage problem is, but I leave to you the political judgment if this is the time for tax incentives.

Mr. CLAY. Thank you.

Mr. Krinsky.

Mr. KRINSKY. My answer would be similar, Mr. Chairman.

There have been—and as has been discussed earlier this morning—several things that have been proposed in this area.

The mandatory universal pension system—the MUPS system—would provide a minimum pension contribution that employers who provide more generous benefits could offset against their plans—would certainly increase coverage, but it has a mandatory aspect to it which is distasteful to a number of people.

IRA's, which I think the statistics show, probably haven't done the job, although perhaps with more incentives they might. However, I don't think there's any evidence in that participation in pension plans.

Other possibilities include increasing tax incentives to small businesses, but forces seem to be going in the other direction.

I certainly think that 401(k) plans, with their nondiscrimination provisions have had the effect of encouraging a lot of lower-income workers to put away more for retirement. At least the early statistics show that there is more put away for retirement under 401(k) than has been put away before, and that's another possibility. Again, it's a question of whether we're in an climate where we en-

TABLE 1 COMPARISONS FOR RETIREMENT AT NORMAL RETIREMENT AGE (67)

				THE A PLANS -- EXPLICIT								
				A-1 1.0 G.C.O.			A-2 .35 G.C.O.			A-3 .65 G.C.O.		
		Attributable Social Sec			Percents			Percents			Percents	
Final Pay	Yrs Serv	Dollars	%	Dollars	PP	Tot	Dollars	PP	Tot	Dollars	PP	Tot
12000	40	6599	55%	2888	24%	79%	1011	8%	63%	1877	16%	71%
	25	4124	34	1805	15	49	632	5	40	1173	10	44
	15	2475	21	1083	9	30	379	3	24	704	6	26
	10	1650	14	722	6	20	253	2	16	469	4	18
20000	40	9268	46	5019	25	71	1757	9	55	3262	16	63
	25	5792	29	3137	16	45	1098	5	34	2039	10	39
	15	3475	17	1882	9	27	659	3	21	1223	6	23
	10	2317	12	1255	6	18	439	2	14	816	4	16
30000	40	10092	34	8481	28	62	2968	10	44	5512	18	52
	25	6308	21	5300	18	39	1855	6	27	3445	11	33
	15	3785	13	3180	11	23	1113	4	16	2067	7	20
	10	2523	8	2120	7	15	742	2	11	1378	5	13
50000	40	10393	21	20561	41	62	7196	14	35	13365	27	48
	25	6496	13	12851	26	39	4498	9	22	8353	17	30
	15	3897	8	7710	15	23	2699	5	13	5012	10	18
	10	2598	5	5140	10	15	1799	4	9	3341	7	12
100000	40	10393	10	51516	52	62	18031	18	28	33485	33	44
	25	6496	6	32197	32	39	11269	11	18	20928	21	27
	15	3897	4	19318	19	23	6761	7	11	12557	13	16
	10	2598	3	12879	13	15	4508	5	7	8371	8	11

TABLE 1 COMPARISONS FOR RETIREMENT AT NORMAL RETIREMENT AGE (67)

				THE B PLANS -- EXISTING TOP-HEAVY LAW											
		Attributable Social Sec		B-1 67% of Pay				B-2 50% of Pay				B-3 58% of Pay			
Final Pay	Yrs Serv	Dollars	%	Dollars	Vari-ance	PP	Tot	Dollars	Vari-ance	PP	Tot	Dollars	Vari-ance	PP	Tot
12000	40	6599	55%	2159	-25%	18%	73%	1677	66%	14%	69%	1677	-11%	14%	69%
	25	4124	34	1677	-7	14	48	1677	165	14	48	1677	43	14	48
	15	2475	21	1677	55	14	35	1677	342	14	35	1677	138	14	35
	10	1650	14	1677	132	14	28	1677	563	14	28	1677	258	14	28
20000	40	9268	46	5040	0	25	72	2796	59	14	60	3326	2	17	63
	25	5792	29	2796	-11	14	43	2796	155	14	43	2796	37	14	43
	15	3475	17	2796	49	14	31	2796	324	14	31	2796	129	14	31
	10	2317	12	2796	123	14	26	2796	537	14	26	2796	243	14	26
30000	40	10092	34	10735	27	36	69	5877	98	20	53	8163	48	27	61
	25	6308	21	4193	-21	14	35	4193	126	14	35	4193	22	14	35
	15	3785	13	4193	32	14	27	4193	277	14	27	4193	103	14	27
	10	2523	8	4193	98	14	22	4193	465	14	22	4193	204	14	22
50000	40	10393	21	23246	13	46	67	15150	111	30	51	18960	42	38	59
	25	6496	13	11281	-12	23	36	6989	55	14	27	8602	3	17	30
	15	3897	8	6989	-9	14	22	6989	159	14	22	6989	39	14	22
	10	2598	5	6989	36	14	19	6989	288	14	19	6989	109	14	19
100000	40	10393	10	55153	7	55	66	38962	116	39	49	46581	39	47	57
	25	6496	6	31223	-3	31	38	21103	87	21	28	25866	24	26	32
	15	3897	4	15270	-21	15	19	13978	107	14	18	13978	11	14	18
	10	2598	3	13978	9	14	17	13978	210	14	17	13978	67	14	17

TABLE 1 COMPARISONS FOR RETIREMENT AT NORMAL RETIREMENT AGE (67)

				THE C PLANS -- EXISTING NON TOP-HEAVY LAW											
		Attributable Social Sec		C-1 67% of Pay				C-2 50% of Pay				C-3 58% of Pay			
Final Pay	Yrs Serv	Dollars	%	Dollars	Variance	PP	Tot	Dollars	Variance	PP	Tot	Dollars	Variance	PP	Tot
12000	40	6599	55%	2159	-25%	18%	73%	216	-79%	2%	57%	1130	-40%	9%	64%
	25	4124	34	0	-100	0	34	0	-100	0	34	0	-100	0	34
	15	2475	21	0	-100	0	21	0	-100	0	21	0	-100	0	21
	10	1650	14	0	-100	0	14	0	-100	0	14	0	-100	0	14
20000	40	9268	46	5040	0	25	72	1802	3	9	55	3326	2	17	63
	25	5792	29	254	-92	1	30	0	-100	0	29	0	-100	0	29
	15	3475	17	0	-100	0	17	0	-100	0	17	0	-100	0	17
	10	2317	12	0	-100	0	12	0	-100	0	12	0	-100	0	12
30000	40	10092	34	10735	27	36	69	5877	98	20	53	8163	48	27	61
	25	6308	21	3555	-33	12	33	520	-72	2	23	1948	-43	6	28
	15	3785	13	0	-100	0	13	0	-100	0	13	0	-100	0	13
	10	2523	8	0	-100	0	8	0	-100	0	8	0	-100	0	8
50000	40	10393	21	23246	13	46	67	15150	111	30	51	18960	42	38	59
	25	6496	13	11281	-12	23	36	6221	38	12	25	8602	3	17	30
	15	3897	8	3304	-57	7	14	269	-90	1	8	1697	-66	3	11
	10	2598	5	0	-100	0	5	0	-100	0	5	0	-100	0	5
100000	40	10393	10	55153	7	55	66	38962	116	39	49	46581	39	47	57
	25	6496	6	31223	-3	31	38	21103	87	21	28	25866	24	26	32
	15	3897	4	15270	-21	15	19	9198	36	9	13	12055	-4	12	16
	10	2598	3	7293	-43	7	10	3245	-28	3	6	5150	-38	5	8

TABLE 2 COMPARISONS FOR EARLY TERMINATIONS

						THE A PLANS -- EXPLICIT								
Pay		Age		Attributable Social Sec		A-1 1.0 G.C.O.			A-2 .35 G.C.O.			A-3 .65 G.C.O.		
On Date of Quit	Inflated to NRD	Start- ing	Quit- ing	Dollars	%	Dollars	Percents PP	Tot	Dollars	PP	Tot	Dollars	PP	Tot
12000	69796	17	27	7786	11%	4125	6%	17%	1444	2%	13%	2682	4%	15%
	44944		37	10205	23	4863	11	34	1702	4	26	3161	7	30
	44944	27	37	6378	14	3040	7	21	1064	2	17	1976	4	19
	28941		47	8292	29	3640	13	41	1274	4	33	2366	8	37
	28941	37	47	5528	19	1820	6	25	637	2	21	1183	4	23
	18636		57	6744	36	2521	14	50	882	5	41	1638	9	45
	18636	47	57	5058	27	1260	7	34	441	2	30	819	4	32
20000	116327	17	27	11002	9	6652	6	15	2328	2	11	4324	4	13
	74906		37	14606	19	7902	11	30	2766	4	23	5136	7	26
	74906	27	37	9129	12	4939	7	19	1729	2	14	3210	4	16
	48234		47	11970	25	5970	12	37	2089	4	29	3880	8	33
	48234	27	47	7980	17	2985	6	23	1045	2	19	1940	4	21
	31059		57	9696	31	4170	13	45	1460	5	36	2711	9	40
	31059	47	57	7272	23	2085	7	30	730	2	26	1355	4	28
30000	174491	17	27	13078	7	9796	6	13	3428	2	9	6367	4	11
	112360		37	17285	15	11824	11	26	4138	4	19	7686	7	22
	112360	27	37	10803	10	7390	7	16	2587	2	12	4804	4	14
	72351		47	13848	19	9387	13	32	3286	5	24	6102	8	28
	72351	37	47	9232	13	4694	6	19	1643	2	15	3051	4	17
	46589		57	10848	23	6716	14	38	2350	5	28	4365	9	33
	46589	47	57	8136	17	3358	7	25	1175	3	20	2183	5	22
50000	187266	17	37	18730	10	28216	15	25	9876	5	15	18341	10	20
	120586	27	47	14808	12	23088	19	31	8081	7	19	15007	12	25
	120586	37	47	9872	8	11544	10	18	4040	3	12	7504	6	14
	77648		57	11384	15	15892	20	35	5562	7	22	10330	13	28
	77648	47	57	8538	11	7946	10	21	2781	4	15	5165	7	18

TABLE 2 COMPARISONS FOR EARLY TERMINATIONS

						THE B PLANS -- EXISTING TOP-HEAVY LAW											
Pay		Age		Attributable Social Sec		B-1 67% of Pay				B-2 50% of Pay				B-3 58% of Pay			
On Date of Quit	Inflated to NRD	Starting	Quitting	Dollars	%	Dollars	Variance	PP	Tot	Dollars	Variance	PP	Tot	Dollars	Variance	PP	Tot
12000	69796	17	27	7786	11%	1950	-53%	3%	14%	1950	35%	3%	14%	1950	-27%	3%	14%
	44944		37	10205	23	1950	-60	4	27	1950	15	4	27	1950	-38	4	27
	44944	27	37	6378	14	1950	-36	4	19	1950	83	4	19	1950	-1	4	19
	28941		47	8292	29	1950	-46	7	35	1950	53	7	35	1950	-18	7	35
	28941	37	47	5528	19	1950	7	7	26	1950	206	7	26	1950	65	7	26
	18636		57	6744	36	1950	-23	10	47	1950	121	10	47	1950	19	10	47
	18636	47	57	5058	27	1950	55	10	38	1950	342	10	38	1950	138	10	38
20000	116327	17	27	11002	9	3250	-51	3	12	3250	40	3	12	3250	-25	3	12
	74906		37	14606	19	3250	-59	4	24	3250	17	4	24	3250	-37	4	24
	74906	27	37	9129	12	3250	-34	4	17	3250	88	4	17	3250	1	4	17
	48234		47	11970	25	3250	-46	7	32	3250	56	7	32	3250	-16	7	32
	48234	37	47	7980	17	3250	9	7	23	3250	211	7	23	3250	68	7	23
	31059		57	9696	31	3250	-22	10	42	3250	123	10	42	3250	20	10	42
	31059	47	57	7272	23	3250	56	10	34	3250	345	10	34	3250	140	10	34
30000	174491	17	27	13078	7	4874	-50	3	10	4874	42	3	10	4874	-23	3	10
	112360		37	17285	15	4874	-59	4	20	4874	18	4	20	4874	-37	4	20
	112360	27	37	10803	10	4874	-34	4	14	4874	88	4	14	4874	1	4	14
	72351		47	13848	19	5077	-46	7	26	4874	48	7	26	4874	-20	7	26
	72351	37	47	9232	13	4874	4	7	19	4874	197	7	19	4874	60	7	19
	46589		57	10848	23	4874	-27	10	34	4874	107	10	34	4874	12	10	34
	46589	47	57	8136	17	4874	45	10	28	4874	315	10	28	4874	123	10	28
50000	187266	17	37	18730	10	8723	-69	5	15	8124	-18	5	15	8124	-56	5	15
	120586	27	47	14808	12	11034	-52	9	21	8124	1	9	21	8891	-41	9	21
	120586	37	47	9872	8	8124	-30	7	15	8124	101	7	15	8124	8	7	15
	77648		57	11384	15	10127	-36	13	28	8124	46	13	28	8124	-21	13	28
	77648	47	57	8538	11	8124	2	10	21	8124	192	10	21	8124	57	10	21

courage such savings. Things seem to be going in the other direction.

Mr. Clay. Thank you.

Mr. Lebenson. To add to the idea of incentives that we discussed before, I think it's terribly important to bring a degree of stability to the system, avoiding an annual round of legislative change.

Last week, the IRS issued statistics on plan approvals for 1984, and, for the first year in a long time, they're significantly down—36 percent lower than they had been in 1983.

The drop is most noticeable in the area of defined benefit plans. As a matter of fact, almost as many defined benefit plans terminated in 1984 as were qualified by the Internal Revenue Service. I, frankly, believe that that's largely the result of one piece of legislation after another which, for the small plan sponsor, even if the legislation doesn't have a material effect on his plan, the cost of implementing the changes is a deterrent to his continuation or establishment of the program.

Mr. Clay. Thank you.

Mrs. Roukema.

Mrs. Roukema. Thank you, Mr. Chairman.

I do apologize for not being here earlier.

Mr. Clay. You're forgiven.

Mrs. Roukema. Thank you. I knew the panels were in good hands.

We sat through a series of panels yesterday that primarily focused on the governmental responsibility as well as the point of view of labor.

You have more of a direct relationship to the business or the employer's side of the issue, and I'm sorry I didn't hear your entire testimony, but I've got to tell you that it seems as though everyone is swearing fidelity to the concept—the concept of a national retirement income—and making it sound almost too easy to be true. Now, I don't know if this group has done that.

Mr. Chairman, has this group done that as well?

Mr. Clay. Yes; yes.

Mrs. Roukema. Well, it's difficult to know which question to ask first, so I'm going to throw out a general question, and then hopefully you can answer it from your own perspective.

The general question is, if it's all so easy, then why haven't we been able to get anything either out of committee or to the floor or, heretofore, get any commonality of agreement from the different parties?

Nobody seems to be willing to put their finger on what is really at issue here in specific terms. We're only talking about generalities.

Second, we are indeed seeing politics making strange bedfellows when we have the AFL–CIO and the Chamber of Commerce and all the business groups agreeing that we should not eliminate the tax benefits on employees' fringe benefits, which both groups seem to agree is the foundation for a national retirement income policy.

This is all very confusing to us Republicans, who are finding the administration and some Democrats going off in an entirely different direction.

Can each of you just address yourself to what you think is the central problem that this committee has to resolve if we are going to have a national retirement policy?

Mr. CLAY. That's a good question.

Mrs. ROUKEMA. It's a good question, but I wish we had some answers.

Mr. FAY. Apparently you haven't gotten them in the past, and I suspect I won't be able to give anything either, but let me try a little bit.

Mrs. ROUKEMA. That will not prejudice my opinion of you. I know you are dealing with difficult issues.

Mr. FAY. First of all, I must have failed in my testimony if I gave the impression that everything was too easy.

Mrs. ROUKEMA. I didn't hear your testimony, I'm sorry.

Mr. FAY. We feel that everything has been too tough, and we certainly would concur that the best thing you can do for a while is nothing. That would be an act of greatness. We really need a moratorium to digest what has already been done.

I think the congresswoman is correct, however, in that there is conflicting policy. The purpose of this meeting is to set a framework for analyzing Treasury proposals which provide for a cutback of tax provisions that encourage employee benefit plans, and yet some of your witnesses, rather than addressing that issue, have said, "Well, we have to have more benefits; we have to have minimum benefits; we have to have faster vesting; we need portability."

From the businessman's viewpoint, he's caught in the middle—more costs but more benefits. That's not easy, and there's certainly reason for anybody to be confused, because certainly the businessman is confused.

What is needed—and that's why I think these hearings are so important—is not legislation so much, but an analysis of the situation, a determination of what we're trying to do, and a commitment to that, understanding that any policy is going to have some drawbacks.

Perfection is not possible in our world, but we should be able to agree upon what it is we're trying to do, As far as policy directions, both coming from the administration and Congress, they're schizophrenic; they're coming from all different directions.

Mr. KRINSKY. I think I would agree with my colleague on the panel here that it is certainly not an easy question. I think labor and business are unified in not wanting legislation to be done for the purpose of tax simplification. When the legislation really affects retirement income policy tremendously even though no one is thinking directly of retirement income policy.

So, what we are all urging, is that someone think of retirement income policy first. Then, if there is going to be legislation—and I agree; I think the best thing would be none—but, if there is going to be legislation, that it be done within that policy.

What is going to happen if there is no policy and there is no action by this committee, is that all of this will be conceded to the tax-writing committees and to tax simplification. Tax simplification affects retirement income policy tremendously. It takes away many of the incentives for the employers to set up private pension plans.

In addition to tax simplification legislation, there is legislation in the tax-writing committees about tax contributions to health care. All of that has a tremendous effect on these issues.

So, what we are pleading for, is a look at the issues first, and then, if there is going to be legislation, that it fit within that policy. The policy should not happen as a result of tax legislation when nobody has thought through the results. I think that's what we're pleading for, and that's why business and labor easily unite on this issue, because it affects them very much the same way.

Mr. LEBENSON. I certainly have to agree with what the gentleman has said before me.

Perhaps what I am about to say is a little bit too harsh, but from our perspective, we have seen the President's Commission convened, give its report in 1981, and call for national retirement income goals along the lines that Mr. Erlenborn and I addressed this morning. We have not seen any motion in that direction whatsoever.

We've seen the National Pension Forum conduct hearings last year, and, again, I'm not aware of any activity toward bringing some of their recommendations—which included the establishment of a national retirement income policy—forward, other than the action that this committee is taking right now.

I would be frank to admit, I'm not in Washington every day, and I don't know what goes on every single day down here, but it does seem to us that there is a great deal of jurisdictional conflict here reflected in the tax-writing committees taking their positions on the basis of revenue and not on the basis of retirement income policy.

Maybe I'm doing no more than restating what the problems are without offering solutions, but that's what I feel.

Mrs. ROUKEMA. Then none of you are really intent on seeing us move faster on minimum vesting standards or integration. I believe this gentleman spoke about the need for integration or movement in that direction.

Mr. LEBENSON. We submitted an outline of specific proposals regarding both revisions to integration and the acceleration of vesting, but it's our feeling that immediate movement, in view of changes that began with ERTA in 1981—and I admit that these were all tax law changes—TEFRA in 1982, and DEFRA in 1984. Particularly in the small plan area, where I think it's relatively universally recognized that the coverage gaps primarily exist, the small employers will simply not be able to cope with added legislation immediately.

I think a terribly good idea would be to include in a national retirement income policy—and I'm not talking about just for the immediate future—some form of recognition of the long-term nature of the retirement income system such that legislation isn't passed changing these plans every single year on a relatively expedient basis or that, if such legislation is passed, there be some degree of coherence in the effective dates of that legislation, so that a plan doesn't have to be amended every year; at least it can be amended once every 5 years to take care of everything that's happened in that 5-year period.

Mrs. ROUKEMA. Thank you, Mr. Chairman.

Mr. CLAY. Thank you.

Mr. Hayes.

Mr. HAYES. Excellent prepared testimony, and time constraints keep me from raising maybe some questions I would raise.

I would just like to compromise and pose, I guess—you've all indicated, as I understood it, an opposition to taxing benefits as such. Am I being presumptuous when I say that?

[No response.]

Mr. HAYES. I appreciate this sort of partnership approach to it. I'm somewhat familiar, Mr. Krinsky, with your firm, having been on the other side of the collective bargaining table when we negotiated improved pension and welfare plans which your firm managed, to some extent, in Chicago.

I just want to say that I hope the position that you've indicated here, in being in opposition to taxing benefits, is transmitted to at least that body of Congress where there seems to be some weakness in this area, the Ways and Means Committee. Don't let your testimony stop here, please, and your position be known here. I just want to say that.

Mr. CLAY. Thank you.

Mr. Owens.

Mr. OWENS. No questions, Mr. Chairman.

Mr. CLAY. We certainly want to thank you for your testimony. That concludes today's hearings.

[Whereupon, at 12:35 p.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

Statement of the Alliance of American Insurers
to the
Subcommittee on Labor-Management Relations
Committee on Education and Labor
U.S. House of Representatives
April 10, 1985
on the Treasury Department's proposal to tax
workers compensation benefits

We appreciate the opportunity to present our views on the Treasury Department's proposal to tax employee benefits. The Alliance of American Insurers is a trade association of approximately 175 property/casualty insurance companies that write many lines of insurance, including workers compensation, in all 50 states and the District of Columbia. Along with a wide-ranging coalition of insurers, industry groups and labor unions, we are very concerned about the Treasury Department's attempt to tax the employee benefits upon which America's workers and their families depend. The Alliance is especially opposed to the Treasury's proposal to tax the workers compensation benefits that injured workers rely on for their livelihoods. These benefits should not be taxed, for the following reasons:

1. The proposal is unfair to injured workers. Treasury asserts that its scheme is "fairer" because, under the current system, a worker with income entirely from wages pays more in taxes than a worker with the same income from workers compensation benefits. It is certainly unfair, however, to take $2 billion over the next five

years from injured workers and their families who need their full benefits more than at any other time. It is not fair that, while Treasury would tax compensation benefits, another person with the same injury suffered outside work would pay no tax on any of the tort damages received. Nor is it fair that compensation beneficiaries, who can receive at most 66-2/3% of their pre-injury wages and already must pay expenses such as attorney's fees out of their benefits, must have them further lowered by federal taxes. Treasury's comparison is incorrect, as well -- the injured worker's income should be compared with his or her pre-injury compensation. A proposal that takes away an injured worker's benefits when they are needed the most simply cannot be described as fair.

2. The states are best qualified to determine the appropriateness of benefit levels. The Treasury's proposal is another attempt by the federal government to usurp the states' authority in an area where the states are meeting their responsibilities. The adequacy of workers compensation benefits is peculiarly the states' proper preserve, for only they can respond adequately and flexibly to local conditions. Federal intervention only weakens the states' ability to respond to local circumstances. No allowance is made, for example, for those states which consider only after-tax income in computing benefits. The

states, not the federal government, are best equipped to determine what is fair for their workers and what incentives are needed to induce injured employees to return to their jobs. Federal tax policy is a peculiarly bad tool to use for this purpose.

3. Increased cost for American business. At a time when the nation is staggering under an unprecedented foreign trade deficit, and when the Treasury's own proposal would increase the tax burden on American business, it is extremely inappropriate to increase businesses' non-tax costs of doing business. Yet this is exactly what this proposal would do. States would be strongly pressed to increase their benefit levels. To the extent they are increased, workers compensation insurance costs will increase. Since tort plaintiffs are not taxed on personal injury recoveries, attacks on the exclusiveness of the workers compensation remedy will be exacerbated. If they are successful, insurance costs will increase even more and the compensation system will be further damaged. As the cost of labor is increased, business will be forced to automate even more, displacing workers and increasing social insurance costs.

This proposal is simply too costly for any of us to afford. We ask the members of this subcommittee, and the Congress as a whole, to remember this when tax "simplification" is debated this year.

STATEMENT FOR THE RECORD
AMERICAN ACADEMY OF ACTUARIES
PENSION COMMITTEE
TO THE SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS
HOUSE COMMITTEE ON EDUCATION AND LABOR
HEARINGS ON EMPLOYEE BENEFITS AND THE NEED FOR A NATIONAL RETIREMENT INCOME POLICY

APRIL 25, 1985

The American Academy of Actuaries ("Academy") appreciates the opportunity to provide testimony to the House Committee on Education and Labor and its Subcommittee on Labor-Management Relations. The Academy feels that the development of a national retirement income policy is one of the more important issues in the area of employee benefits and we appreciate the opportunity to participate in your deliberations.

Background

The Academy is a professional association of over 7,800 actuaries involved in all areas of specialization within the actuarial profession. Included within our membership are approximately 85% of the enrolled actuaries certified under the Employee Retirement Income Security Act of 1974 (ERISA) as well as comparable percentages of actuaries providing actuarial services for other employee benefit plans such as life, health and disability plans. As a national organization of actuaries, the Academy is unique in that it includes actuaries with expertise in all areas of actuarial specialization.

With respect to government relations, the Academy views its role as a provider of information and actuarial analysis in order that policy decisions may be made with informed judgment. It is our belief that the training and experience of Academy members allows for a unique understanding of current practices in employee benefits. It is our intention to communicate that understanding in ways that assist public policymakers.

We believe that the Academy is uniquely able to assist in deliberations relative to a national retirement income policy. The members of the Academy practicing in the retirement plan area possess a wealth of understanding and background relative to the dynamics of these programs and their impact on those who are receiving or will receive benefits from them. We would like at this time to offer the services of our Pension Committee and our staff, to provide whatever assistance we can in helping you design such a national retirement income policy.

Key Elements of National Retirement Income Policy

The greying of America continues. As progress in the care and treatment of medical problems becomes more and more successful, the longevity of older Americans is increasing. The trend to earlier retirement which marked the 1960's and 1970's has abated somewhat, but has not yet turned. As a result, it is likely that Americans will spend a greater portion of their lives in a retired state than ever before.

It is said by some that the trends in retirement age will turn and that people will remain active at work well into their 60's. Certainly the 1983 Social Security amendments will encourage this trend. However, whether the downward trend in retirement ages will reverse, and the timing and extent of any such reversal is quite unclear at the present time. Retirement age patterns have a major impact on the actuarial costs of retirement systems, both public and private. They also have other major impacts on the composition of the nation's workforce and the economy in general. A national retirement income policy could well address this issue.

The traditional view of the mechanisms for retirement in the United States are characterized by the analogy of the three-legged stool:

(1) Social Security serves as a floor of retirement income for most workers in the United States and their dependents.

(2) Retirement programs sponsored by employers for their employees provide substantial additional retirement income.

(3) Personal savings by individuals supplement the other legs.

Social Security

While the Social Security amendments of 1983 resolved serious financial problems within the Social Security system and recognized long term demographic trends in its benefit structure, the feeling that Social Security "won't be there when I retire" remains prevalent throughout the United States. The current debate relative to the contribution to be made by Social Security towards resolving the problem of federal deficits does nothing to calm such feelings.

Another factor in providing retirement income security through social insurance programs in the United States is the manner in which health care will be provided to older Americans and how it will be financed. It is widely understood that there is a looming financial problem in the Medicare program. The long-term structure of this program and the extent to which older Americans will be required to contribute to the costs of medical services has a major impact on retirement planning for current workers as well as a direct impact on current beneficiaries of the program. We would also observe that there is no longer a consistency between the normal retirement age under OASDI and the eligibility age under HI since the Social Security Amendements of 1983.

We are concerned that recent reports postponing the date the HI Trust Fund is exhausted until the mid or late 1990's provides a false sense of security, and a justification for inaction by Congress. The inevitable increase in the aged population, together with certain escalations in medical costs, mean that the Medicare program faces a real and threatening financial crisis. This is not an issue which will disappear over time. We urge prompt attention to the need for financial reform of the program, inasmuch as the longer such reforms are delayed, the greater will be the impact of rescue measures which will have to be undertaken. By making smaller, less burdensome changes in the early years, greater changes to the program which would otherwise be necessary to insure its survival can be avoided.

Thus, in any national retirement income policy, it is essential that:

(1) A commitment be made to support a financially sound OASDI program that has credibility with the public.

(2) That a policy be established relative to the delivery of and payment for health care services for older Americans.

(3) Policy in both areas remain stable so that Americans can plan for their retirement needs.

Retirement Programs Related to Employment

The development of retirement programs sponsored by or contributed to by employers was substantial in the thirty years following the end of World War II. This explosion was encouraged by tax incentives, labor negotiations, and other employee relations considerations. A large percentage of employers sponsored defined benefit plans for their employers. Over the years, these were liberalized and defined contribution plans were added to the mix.

In the last decade, however, the development of new defined benefit plans has come to a virtual halt. Defined benefit plans are being terminated; some plans are being replaced by defined contribution plans. The reasons for such terminations vary widely. Corporate mergers and acquisitions are sometimes involved. Uncertain corporate finances often are a factor. An uncertain and rapidly changing regulatory environment is frequently cited. Finally, such requirements as PBGC participation and FASB accounting standards that are applicable to defined benefit plans and not defined contribution plans creates a further burden on the former. We question whether the trend from defined benefit to defined contribution plans is in the public interest in providing greater retirement income security.

There is a place for both defined benefit and defined contribution programs in the provision of income to retired workers and their families. Defined benefit plans provide the promise to employees of a retirement income reasonably related to salary. However, the cost to the employer may vary considerably. Defined contribution plans, on the other hand, have a known cost to the employer, but do not provide a known level of benefits, since the economic risk associated with potential return on pension investment is transferred to the employee. Defined contribution plans are often used as a supplement to defined benefit plans, and can be tailored to the current economic requirements of employees through salary reduction plans such as those under Section 401(k) of the Internal Revenue Code, or cafeteria plans which permit employees to allocate their current benefit dollars among various programs which most directly meet their current needs.

Many settlements under defined contribution plans tend to be in lump-sums rather than annuities for life. A national retirement income policy should recognize that lump-sum settlements may not always be used for retirement purposes, nor do they provide a retirement income than cannot be outlived.

Tax policy has a major and significant impact on both defined benefit and defined contribution plans, and must be carefully reviewed not only from the viewpoint of tax receipts, but also the impact on retirement security. The distinction between tax exemption and tax deferral is not alway properly recognized in tax debates and invalid analyses may result. "The time value of money" is an important actuarial analytical tool and actuaries can make major contributions in providing meaningful and valid comparisons among alternatives.

In addition to providing retirement benefits to older Americans, these programs serve a vital role in the national economy. They have become a substantial source of capital upon which long-term economic strength and vitality is based. A national retirement income policy should not be developed in a vacuum and broader economic effects should be considered.

We believe that any national retirement income policy should encourage the continued existence of a vital, dynamic private pension system. The most positive accomplishment of the Congress in this area would be to create an environment in which private pension plans would thrive. Both public and private sector programs are necessary to achieve adequate retirement income levels.

Further, this environment should be characterized by stability. Three major congressional enactments since 1982 have affected the retirement plan regulatory environment and have forced several sets of changes to virtually every retirement plan in the United States. This has imposed a significant administrative burden and increased uncertainty and confusion among plan participants. It also stimulates plan terminations and discourages new plan formations. The ideal environment would be created by establishing a well-designed regulatory pattern and by allowing it to operate without substantial changes each year.

Individual Savings

The extension of Individual Retirement Accounts contained in the 1981 Tax Act (ERTA) is now providing most Americans with a tax incentive to save for retirement. This should, over the long-term future, have a meaningful impact on the meeting of the retirement income needs of older Americans. However, retirement income security would be enhanced if the percentage of working Americans participating in such programs, particularly at the lower income levels, were higher.

The role of other savings programs, such as those under the Section 401 (k) of IRC, needs to be addressed in any national retirement income policy. Currently, disagreement exists concerning the extent to which such programs promote savings for retirement purposes or for other purposes.

Summary

In summary, the Academy appreciates the opportunity to be a part of the deliberation on this most important matter. We feel that the Academy can play an important role as an objective provider of information to your deliberations. The members of the Academy have unique talents and perspectives in this area which we would be happy to make available to the committee.

The development of a national retirement income policy is a very complex matter; dealing with not only the income needs of retirees and the expected future demographics of our population, but also with questions of capital formation, and the balancing of interest between employers and employees, between the need for a tax revenue and encouragement of social good. The Academy feels that stability should be the hallmark of any such policy.

A national retirement income policy could become one of the most important future forces shaping the social fabric of the United States.

American Academy of Actuaries

Pension Committee

Norman S. Losk, Chairman
James F. A. Biggs
Thomas P. Bleakney
Yuan Chang
Darrel J. Croot
Paul L. Engstrom
Paul A. Gewirtz
Joseph A. LoCicero
Thomas M. Malloy
Donald M. Overholser
Michael J. Tierney
Larry D. Zimpleman

ACA

AMERICAN CHIROPRACTIC ASSOCIATION

1916 Wilson Boulevard, Arlington, Virginia 22201 (703) 276-8800

April 24, 1985

Honorable William L. Clay, Sr., Chairman
Subcommittee on Labor-Management Relations
House Committee on Education and Labor
United States House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

The Subcommittee on Labor-Management Relations recently held hearings on a National Retirement Income Policy and the role in such a policy of the Employee Retirement Income Security Act (ERISA). The American Chiropractic Association would like to submit this letter for the record of those hearings in the hope of drawing the Subcommittee's attention to a related ERISA problem -- a facet of current law that is limiting, rather than broadening, the employee benefits beneficiaries' choices in seeking optimum health care.

Most states have enacted state insurance equality laws that protect the rights of a person in a health plan to select whomever he or she wants for a particular health service. This is, of course, as long as the provider is a licensed health practitioner in the state in question.

When ERISA was enacted in 1974, it contained a preemption clause that was intended to override state laws that might interfere with the establishment and operation of uniform pension and benefit plans. This type of preemption was probably necessary for the sake of national uniformity, but it is now being used to restrict freedom of choice rather than broaden it, and to deny employees a full range of options rather than protecting all their options.

A conflict exists between the state insurance equality statutes and the ERISA federal preemption provision. Some employee benefit plans are utilizing ERISA's preemption clause to override state insurance equality laws, and have limited reimbursement for health benefits to only doctors of medicine or certain other selected health care practitioners.

In our view, this use of the preemption clause was not contemplated by the Congress at the time ERISA was enacted. It is having an anticompetitive effect in a field where competition should be encouraged, rather than discouraged, particularly at this time of increasing health care costs. It is clearly restrictive of a person's right and ability to select the health care practitioner of his or her choice.

The ACA believes that if the ERISA law is addressed by your Subcommittee this year, this problem of preemption of state insurance equality laws can be addressed without endangering or diluting the real purpose of ERISA's preemption clause. Congressman Fortney H. Stark, Chairman of the House Ways and Means Subcommittee on Health, has introduced H. R. 1375, legislation to protect the employee's right to receive health care under an employee welfare benefit plan from the practitioner of his or her choice. The bill also prevents discrimination against legally qualified health care practitioners. Congressman Stark's legislation preserves a basic individual right, continues to recognize the customary preeminence of the state in the regulation of insurance, and clearly enhances competition. We commend H. R. 1375 to you, Mr. Chairman, and urge that your Subcommittee carefully consider it as you contemplate changes to the basic ERISA law.

Thank you for you consideration in this matter. Should you have questions with which you believe the ACA can be of assistance, please let us know.

Sincerely,

W. Randall Rawson
Director of Governmental Affairs

American
Dental
Association

[illegible]
[illegible]
[illegible]
[illegible]

April 23, 1985

The Honorable Bill Clay, Chairman
Subcommittee on Labor-Management Relations
House Committee on Education and Labor
2451 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

We commend the Subcommittee for reviewing the extremely complex area of employee benefits and the impact that various tax and other proposals could have on these benefits. Of specific concern to the American Dental Association are the efforts to impose taxes on employees for all or part of their employer health benefit contributions. We ask that these comments be included in the hearing record of April 23, 1985.

Employer sponsored health benefits have formed the basis for assuring that employees and their families at all income levels are provided adequate protection against the costs of illness. This very beneficial development of workplace health benefits has been stimulated by the effective efforts of employee organizations. It has been made possible because of the current tax laws, which affirm that it is good social policy to encourage the availability of these benefits to American workers.

Dental prepayment plans represent one of the most demanded and fastest growing health benefits. The unique structure of dental plans, with emphasis on preventive services, has played a significant role in improving the oral health of dental benefits recipients. The rapid growth of dental benefit plans, which now cover over 100 million people, has been accomplished without undue increases in the costs of dental services. It is the American Dental Association's view that the growth of these dental plans and the benefits provided to those who are covered validates the social policies upon which the current tax considerations are based.

Therefore, the American Dental Association vigorously opposes proposed changes in the tax laws which in effect would penalize employees who receive very important health benefits.

Legislation has been introduced that would treat the entire amount of an employer's contribution for health benefits as taxable employee income. It is anticipated that the Administration will reintroduce legislation to treat portions of these contributions as taxable income for the employee. In either case the basic incentive of this legislation will be to encourage employees to reduce their health protection. Additionally employees and their bargaining organizations may attempt to shift employer contributions for benefits in order to avoid or at least reduce the tax consequences of maintaining adequate health insurance protection.

The Association also has a basic concern that these incentives could in fact cause some individuals to be underinsured and unable to face the costs of a lengthy illness. The Association also has some very strong and specific objections to this proposal because of its adverse impact on the dental care received by American workers and their families.

Various Congressional and other studies have made it clear that if health benefits are to be taxed, individuals will drop their dental benefits in order to avoid taxation. We believe this will occur under either of the approaches currently being advocated. For this reason alone, this tax should not be enacted.

For a more in-depth discussion of our concerns with this tax proposal, we have attached a copy of a booklet entitled, "Taxing the Nation's Health: A Step Backward". We ask that this booklet be made a part of the hearing record.

A second area of concern involves the need to make certain amendments in the Employee Retirement Income Security Act.

Specifically, the Association would urge the Subcommittee to consider and support H.R. 1375, introduced by Representative Fortney Stark (D-Calif.).

This proposed legislation would make clear that state laws relating to a patient's freedom of choice in employer sponsored non-insured health plans are not preempted by the ERISA statute. As Mr. Stark stated in his opening remarks, this bill would "help protect the employee's right to receive health care under an employee welfare benefit plan from the practitioner of his or her choice".

If enacted, H.R. 1375 would protect statutes in many states requiring reimbursement to dentists and other health care practitioners who have been selected by plan beneficiaries to provide covered services that are within such practitioners' legal scope of practice or license. Also protected would be more recent statutes enacted in some states to allow dentists to choose to participate in employee dental benefit plans. The bill also would allow states to apply standards to assure solvency of benefit plans.

The Association appreciates this opportunity to comment on this vital legislation affecting employer benefits as well as the delivery of quality dental care services in our Nation.

Sincerely,

John L. Bomba

John L. Bomba, D.D.S.
President

attachment

JLB/mlk

American Dental Association
1111 14th Street, N.W.
Washington, D.C. 20005

ADA

The federal government is considering legislation that for the first time would impose a tax on the health care insurance coverage employees receive as benefits from their employers.

The American Dental Association opposes any tax on health care benefits in the strongest possible terms. As a matter of public policy, we believe the government should encourage — not discourage — private sector involvement in providing health benefits protection for American workers and their dependents.

The current tax treatment of employer-provided health benefits, financed through the private sector and rooted in this country's work ethic, encourages a healthy and productive American work force. A reversal of that long-standing and successful policy could lead to the dismantling of the voluntary private system and result in the need for costly governmental programs to provide the protection that American workers and their families need.

A variety of health tax proposals have surfaced in recent months. Provisions of these proposals vary widely — from complete withdrawal of all tax exemptions for employer contributions to health benefits plans on the one hand to the imposition of a limit on the tax-free amount an employee can receive from an employer on the other.

As advocated by the Administration and some members of Congress, the proposed health benefits tax is intended to curb rising health care costs, to equalize taxation for all and to increase federal revenues. In truth, the tax would accomplish none of these goals.

Such a tax would have little effect on those health care systems and benefits plans that have contributed most to health care inflation — major medical and hospital plans — and would unduly penalize dental and other cost-efficient, prevention-oriented benefits that have been among the least inflationary.

But the loss of comprehensive and preventive health coverage could jeopardize the health of American workers and their families. It could have a serious, negative impact on the nation's oral health, reversing the dental profession's successful efforts to protect the public from dental disease through prevention. Years of progress in improving oral health, progress directly linked to the growth of dental prepayment plans, may yield to years of deteriorating oral health.

We question whether it is proper and acceptable public policy for our government to encourage the people of this nation to neglect their health by placing a burdensome tax on health benefits — a tax that would not achieve the goals for which it is intended. We believe the answer is a resounding "no!"

We call upon Congress to join us in opposing this proposal. Any and all efforts to tax the health of the American people should be rejected.

The current tax policy has extended private health benefits coverage to nearly 190 million Americans — including 105 million with workplace dental benefits — most of whom could not otherwise afford the protection these benefits provide.

THE PROPOSED HEALTH BENEFITS TAX

Americans are deeply concerned about the rise in certain types of health care costs. While the American Dental Association shares this concern, we question the value of the Administration's proposed tax on health benefits as a remedy for this national problem.

Under current federal tax policy, employer contributions to employee health benefits premiums are not taxed. This time-tested policy has extended private health benefits coverage to nearly 190 million Americans—including 105 million with workplace dental benefits—most of whom could not otherwise afford the protection these benefits provide.

To combat inflation in certain health care services, the Administration would impose a tax on *all* health care services, regardless of their cost-effectiveness, their inflationary history or their inflationary potential.

To do this, it would require employees to pay taxes on a portion of the health care coverage they receive from their employers as part of their compensation package.

This health benefits tax proposal, which died in the 98th Congress, has been revived and brought forward again in the recent Treasury Department tax reform proposal and in the Administration's Fiscal Year 1986 budget proposal.

Under the Administration's plan, employees with families would be taxed on the amount of employer contributions for health benefits exceeding $175 a month in the first year; the benefits ceiling or "tax cap" for individuals would be $70 per month in the first year. By treating employer contributions for health benefits plans as taxable employee income, the amount contributed also would be subject to Social Security and state income tax payments.

As described and supported by the Administration, this tax is intended to:

- control health care costs by persuading employees to accept benefits plans with greater cost-sharing requirements in order to avoid additional taxes;
- provide greater equity among taxpayers; and
- increase federal tax revenues in the interest of reducing the federal deficit.

These are the Administration's objectives for the proposed health benefits tax. This is the theory. But what, in fact, would actually happen?

The tax proposal has been offered to curb inflationary trends in health benefits systems. In reality, it may contribute to these trends by favoring those health services and benefits plans that have been among the most inflationary—hospital and major medical care.

Consider these facts:

- Between 1967 (the base year for the Consumer Price Index) and 1983 (the most recent year for which complete data are available), the number of Americans with some dental benefits coverage has increased more than 20-fold—from about 5 million in 1967 to nearly 105 million in 1983.
- In the same period, the cost of dental services was 50 percentage points below the rate of increase in physician services and 55 percentage points less than the boost in total medical care costs.
- Also in the same period, dental care costs remained 317 percentage points below the rate of increase in hospital room rates.

The proposed tax would force American workers to choose among various health benefits. To insure against catastrophic illness and injury, and at the same time stay below the tax threshold, it is likely most employees would retain major medical and hospital coverage but relinquish other health benefits.

Many of these other benefits actually hold down family health care costs without contributing significantly to overall health care inflation. For example, dental plans, unlike hospital and medical insurance plans, generally include co-payment and deductible provisions that require patient financial involvement and reduce inflationary trends. These plans help control dental costs by rewarding patients who maintain their oral health and avoid diseases requiring costly restorative care.

The tax proposal has been offered to curb inflationary trends in health benefits systems. In reality, it may contribute to these trends by favoring those health services and benefits plans that have been among the most inflationary.

If the object is cost control, dental benefit plans could be used as a guide for achieving greater cost efficiency in health care coverage.

Moreover, proponents of the health benefits tax cite expensive "first-dollar coverage" as a major contributing factor in health care inflation. This argument ignores the fact that nothing in current tax law prohibits employers from reducing or eliminating first-dollar coverage. Employers already have the flexibility needed to require deductibles and patient cost-sharing to achieve cost-containment. In fact, this is being done today by an increasing number of employers.

If the object is cost control, dental benefit plans could be used as a guide for achieving greater cost efficiency.

Consider these provisions of a standard dental benefit plan:

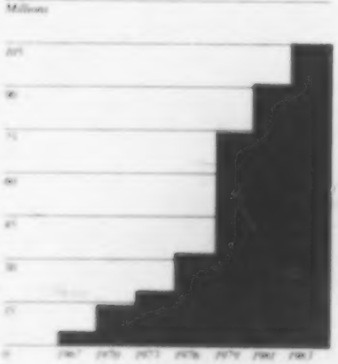
- These plans customarily cover 100 percent of the cost for diagnostic and preventive care – routine oral exams, teeth cleaning, fluoride applications and other treatments designed to stop dental diseases before they start.
- If disease develops and more costly and involved treatments are needed, patients are required to pay a larger share of the cost. Major dental benefit plans generally provide higher levels of benefits for basic restorative treatments (tooth fillings, for example) than for major restorative care – crowns, bridges or dentures.

This method of weighting benefits assures that all plan subscribers maintain a financial interest in their oral health – and share in the cost of restoring it if disease occurs. Patients who fail to care for their teeth properly will incur progressively higher out-of-pocket expenses.

The financial incentive to stay healthy, common to dental benefit plans, traditionally has not been a feature of hospital and medical insurance packages.

As a result, these plans tend to contribute to inflation. A tax that favors these plans will feed the inflationary spiral – an effect contrary to the Administration's stated cost-containment goals.

Number of Americans with Dental Insurance Coverage



WHERE IS THE TAX SAVINGS?

The Administration has cited tax equity (equal treatment of taxpayers) and potential revenue gains as additional goals for its health benefits tax proposal.

On the matter of tax equity, the Administration reasons that tax-free workplace benefits are unfair to those employees who do not receive benefits in their compensation package and who must purchase them with after-tax dollars. A tax on employer-provided benefits, the Administration contends, would foster greater equality. We contend, however, that this inequity should not be resolved by reducing existing tax incentives but by extending them to those who currently do not share them.

Proponents of the health benefits tax also argue that it would produce needed revenues. But revenue projections ignore the strong probability that employees and employee groups facing the prospect of increased taxes would trade taxable health benefits for nontaxed benefits. Predicted revenues would not be realized as employees adjusted their benefits packages to remain below the benefits tax ceiling.

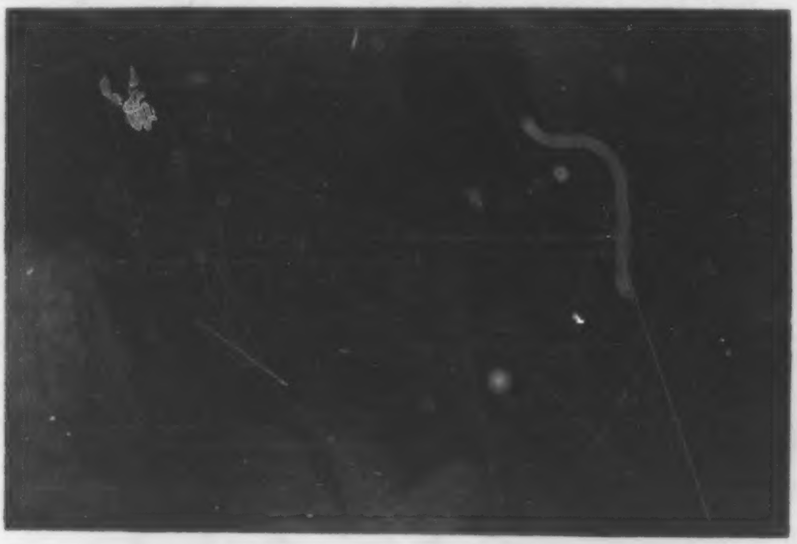
Most importantly, workers abandoning a portion of their health coverage to avoid higher taxes will have been given a government-supported incentive to neglect their health.

Some of these citizens will end up receiving public health care paid for by taxpayers. Where, then, is the tax savings?

Oregon Sen. Robert Packwood, chairman of the Senate Finance Committee, reports that the government foregoes $30 billion in tax revenues each year by not taxing employee benefits. He adds, however, that it would cost the government $80 billion a year to provide health coverage now available through employer-sponsored benefits plans.

The present tax code enables benefits and protections that are clearly in the national interest. A change in that code — a health benefits tax — would undermine a system that has provided health and financial protection for millions. Such a policy would not be in the best interests of the American people.

Workers abandoning a portion of their health coverage to avoid higher taxes will have been given a government-supported incentive to neglect their health.



OPPOSITION TO THE PROPOSAL IS WIDESPREAD

Opposition to the proposed health benefits tax is widespread. Health organizations, health insurers, labor and business representatives, consumer groups, individual health professionals and private citizens are lining up to voice their dissatisfaction with the Administration's proposal.

A telling public commentary is found in two surveys by the Roper Organization for the American Council of Life Insurance and the Health Insurance Association of America.

Both studies assessed attitudes toward employer-sponsored benefits plans and the merits of taxing them. One study surveyed a representative sample of American adults; the other included chief executive officers of large, medium and small U.S. corporations.

Overwhelmingly, both groups regarded employer-provided benefits as extremely important, and neither believed they should be taxed.

Ninety-three percent of the people surveyed rated their health insurance benefits as "very important," and 77 percent said employee benefits should not be taxed. Among corporate executives, 75 percent rated employee benefits as "very important," while 80 percent opposed taxation of benefits.

In 1983, the Rand Corporation published an analysis of tax on health care based on data from its Health Insurance Study. Rand served as insurer for three- and five-year periods for 7,706 people in six localities. Coverage included dental and several other health care services under four plans with varying deductibles and co-payments.

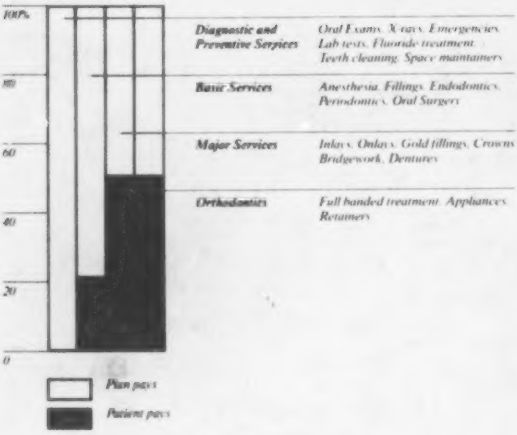
According to the Rand report, a tax on health benefits would result in lowered utilization of health services, and reduced acceptance of certain types of health coverage, including dental coverage.

Rand also said that lowered utilization could "adversely affect the health status of employees and their dependents."

The Congressional Budget Office (CBO), reviewing the potential effects of a similar tax, reported that a benefits tax would favor those services that are "expensive, nonelective and not predictable" and would adversely affect those health services where concern with spiraling costs was least intense.

Noting changes employees would make if health care coverage were taxed, the CBO said "this means that dental services and prescription drug coverage are likely to be reduced by the greatest portion and hospital coverage the least."

Example of patient co-payment in a dental benefits plan



DENTAL HEALTH GAINS THREATENED

The dramatic rise in the number of Americans with dental health coverage coincides with equally dramatic reductions in basic dental diseases.

In the past two decades, the incidence of tooth decay has declined by roughly 50 percent, in part because employer-provided dental benefits have improved access to dental care for millions.

With the threat of tooth decay reduced, the dental profession has concentrated research and treatment efforts on attacking other oral health problems. Most prominent of these is periodontal (gum) disease, which is responsible for about 70 percent of all adult tooth loss. National health surveys conducted since the 1950s demonstrate progress in the battle against gum disease, but there is still much to be done. Despite these advances, gum disease still afflicts three out of four Americans over the age of 35 years.

Without the improved access to dental care fostered by the growth of dental benefits, dentistry's progress in fighting oral diseases could falter.

Simply put, people with dental insurance are more likely to seek the care they need, receiving regular checkups and preventive care designed to stop oral diseases before they start. They are more likely to stay healthy and avoid the expense of major restorative treatment.

Without the benefit of regular preventive dental care, oral diseases now held in check could flourish once more. Others, like periodontal disease, would proceed unabated.

Dental benefit plans offer the most cost-efficient and successful means of maintaining oral health. Measures that adversely affect dental benefits—such as the proposed health benefits tax—could result in a dramatic decline in the nation's oral health.

Dental benefit plans offer the most cost-efficient and successful means of maintaining oral health. The proposed health benefits tax could result in a dramatic decline in the nation's oral health.

The American Dental Association urges Congress to reject any proposal to tax health care benefits. Such a tax would not achieve its intended objectives.

It would jeopardize dental care for the 105 million Americans currently covered by dental plans and discourage millions more from obtaining such coverage.

It would dismantle a public policy of immeasurable social good. It would undermine private-sector involvement in a health insurance system that provides economic security and protection for millions. And it could lead to the renewed call for a government-operated health care system.

AFSCME®

For Release
Friday, May 10, 1985

For more information contact:
Chuck Loveless (202) 429-1188
David Hoffman (202) 429-1130
Bob Kalman, Mercer-Meidinger
(202) 293-9422

EMPLOYEE BENEFITS: TOO TAXING?
INDEPENDENT STUDY SHOWS "ADVERSE IMPACT"

WASHINGTON --

Proposed taxation of health insurance and life insurance benefits would add to the federal income tax burden, especially for low and moderate-income working people, according to a new AFSCME-sponsored study of the impact of taxing fringe benefits.

The study looks at the impact three different ways, including the Treasury Department proposal presented in November, 1984, to tax various fringe benefits. The independent study by Mercer-Meidinger, Inc., a nationally recognized employee benefits consulting firm, uses a computer model to reach the following conclusions:

- a tax on employer benefit plan contributions would significantly increase federal taxes for many low and middle-income public employees, especially those with comprehensive fringe benefits;
- two-earner couples, who are a growing presence in the American labor force would, in particular, be affected severely by the Treasury Department proposal to tax employee benefits;
- a tax on employer medical plan contributions would substantially increase the cost of employer-sponsored medical plans became of "adverse selection" and lead to eventual reductions in medical benefits.
- major changes in current employee benefit tax policy such as proposed by the Treasury Department would weaken the financial security of employees and their families and eventually would have a divisive impact on labor-management relations.

"It is sometimes assumed that taxation of fringe benefits will only affect well-to-do taxpayers. In fact, our study shows the opposite. These shortsighted proposals to tax fringe benefits will clearly hit hard at the financial security of moderate-income working American men and women. This is no tax-the-rich proposal.

THE AMERICAN FEDERATION
OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, AFL-CIO

International Union Headquarters
1625 L Street, N.W.
Washington, D.C. 20036
(202) 452-4800

AFSCME is one of the fastest growing unions in the AFL-CIO. Its more than one million members are state and local government workers committed to achieving dignity and improving their working conditions through collective bargaining. It is the nation's largest public-sector union.

MEMBERSHIP

AFSCME represents more than 1.4 million public employees throughout the United States. They include employees of state, county and municipal governments, school districts, public hospitals and non-profit agencies who work in a cross section of jobs ranging from blue collar, clerical, professional and paraprofessional jobs. White collar employees account for one-third of the membership, while health and hospital workers compose the largest occupational group with about 300,000 members. There are also several thousand federal employees, mostly in the District of Columbia and the Republic of Panama, who are AFSCME members.

STRUCTURE

AFSCME is organized into more than 2,800 local unions, most of them affiliated with one of 80 district councils. Local unions and councils have their own constitutions, elect their own officers and administer a wide variety of local affairs. The International Union coordinates issues of concern to all AFSCME members and provides research, legislative, legal, organizational, educational, public relations and other services.

Two national officers, the president and secretary-treasurer, are elected by convention every four years. They and 25 vice presidents, elected at convention on a regional basis, make up the International Executive Board which meets quarterly to review reports of the officers and staff, determine policy and programs and implement convention resolutions.

AFFILIATIONS

AFSCME is affiliated with the AFL-CIO, of which AFSCME President Gerald W. McEntee is a vice-president. AFSCME is also a member of the Department of Professional Employees and the Industrial Union Department of the AFL-CIO and the Public Services International, a trade secretariat of public employees throughout the world.

HISTORY

AFSCME began as a number of separate locals organized by a group of Wisconsin state employees in the early 1930's. By 1935 there were 30 locals which became a separate department within the American Federation of Government Employees. In 1936 AFSCME was chartered by the American Federation of Labor. By 1955, at the time of the AFL-CIO merger, AFSCME had 100,000 members. The following year, the Union merged with the 30,000-member CIO Government and Civic Employees Organizing Committee. In 1957 AFSCME moved its headquarters from Madison, Wisconsin to Washington, D.C. With the affiliation of the 250,000-member Civil Service Employees Association (CSEA) of New York State in 1978, AFSCME membership surged over the one million mark.

OFFICERS

GERALD W. McENTEE, International President

In 1981, McEntee was elected International President of AFSCME. He was formerly Executive Director of the largest public employee union in Pennsylvania, AFSCME Council 13, an office he had held continuously since 1973. McEntee had also been an International Vice President of AFSCME.

Beginning his career in labor in 1958 as an AFSCME organizer in Philadelphia, McEntee went on to become the successful architect of the major public sector organizing drive to unionize Pennsylvania's more than 75,000 state employees.

McEntee was elected a member of the Executive Council and a Vice President of the AFL-CIO in 1982. He is also a member of the Democratic National Committee and the DNC's Labor Council, a Vice President of Americans for Democratic Action and a member of the board of the American Arbitration Association.

McEntee's father, William, was the principal organizer and leader of AFSCME Council 33, which today continues to represent Philadelphia City Employees.

WILLIAM LUCY, International Secretary-Treasurer

A civil engineer by profession, Lucy worked for Contra Costa County, California, when he was elected president of the county workers' union, AFSCME Local 1675.

Joining the AFSCME international staff in 1966, Lucy served as associate director of the Legislation and Community Affairs Department and as Executive Assistant to the President. Lucy was elected AFSCME International Secretary-Treasurer in 1972.

In its May 1979, edition, *Ebony Magazine* selected Lucy for the fourth consecutive year as one of "The 100 Most Influential Black Americans."

AFSCME.
In the public service

Indeed, the term 'fringe benefits' fails to recognize the importance of these plans in providing basic income security protection to employees and their families," said Gerald W. McEntee, President of the 1.1 million-member American Federation of State County and Municipal Employees.

"These proposals will hit AFSCME members especially hard. It's well-known that state and local government employees frequently trade-off wages for fringe benefits," McEntee continued.

McEntee noted that the average AFSCME member earns $18,000 a year.

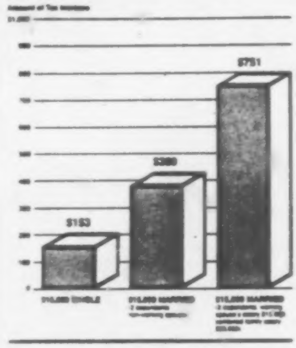
The study uses current tax rates to examine the impact of taxes on fringe benefits because the Administration proposal to lower rates is still unavailable. It also uses the November, 1984, Treasury Department proposal to tax health benefits at $70 a month for single workers and $175.00 a month for family coverage. When President Reagan's tax reform proposals are released, this so-called "cap" approach reportedly may be replaced by a "floor" approach -- in which all workers would be taxed on the first $25.00-a-month of employer-paid health insurance premiums, while most other fringe benefits go untaxed.

The Mercer computer model quantified the tax effect on hypothetical employees who work for the following public employers: University of California, Cook County (Illinois), Milwaukee County (Wisconsin), State of Michigan, Nassau County (New York), and Prince Georges County (Maryland).

Employee Benefits: Too Taxing?

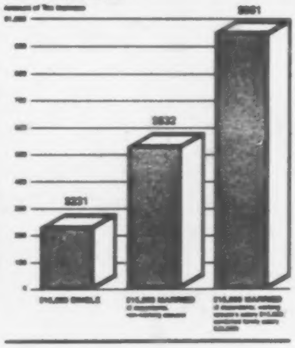
STATE OF MICHIGAN

Proposed Increase in Federal Income and Social Security Tax for a Typical Michigan State Employee



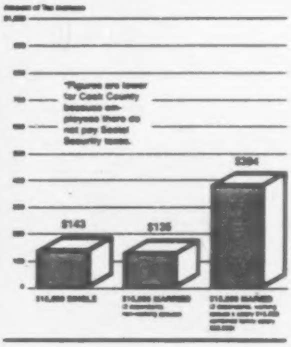
UNIVERSITY OF CALIFORNIA

Proposed Increase in Federal Income and Social Security Tax for a Typical University of California Employee



COOK COUNTY, ILLINOIS

Proposed Increase in Federal Income Tax for a Typical Cook County Employee*



*Figures are lower for Cook County because employees there do not pay Social Security taxes.

AFSCME®
in the public service

WILLIAM M.
MERCER-Meidinger
INCORPORATED

EFFECT OF POSSIBLE CHANGES IN EMPLOYEE BENEFIT TAX POLICY ON STATE AND LOCAL GOVERNMENT EMPLOYEES

Prepared for

American Federation of State, County and Municipal Employees
(AFSCME)

by

William M. Mercer-Meidinger, Incorporated
Washington, D.C.

EXECUTIVE SUMMARY

Employer-sponsored benefit plans provide employees and their families with important disability, survivor, medical, and retirement protection that is essential to individual financial security. These plans are important to employers in attracting and retaining qualified employees and to the U.S. economy in sustaining economic growth through investment of employer-sponsored pension fund assets. Furthermore, employer-sponsored plans reduce the need for benefits provided by federal social insurance programs that would require higher taxes. The Internal Revenue Code has been a catalyst for the growth and development of these plans through special tax treatment of employer contributions, investment income on accumulating assets, and benefit plan distributions.

Recently, proposals have been advanced to change employee benefit tax policy as part of a larger effort to raise federal revenue and simplify the tax system. One of the most highly publicized and controversial proposals thus far has been advanced by the U.S. Treasury Department.

Treasury's recommendations include taxing employees for employer medical plan contributions and employer group term life insurance costs. Currently, these contributions are tax exempt (except for imputed employer life insurance costs for coverage above $50,000).

Using current tax rates, we developed a computer model for AFSCME to quantify the effect on public employees of taxing employer benefit plan contributions under Treasury's proposal and two other possible scenarios. Under

Scenario #1, employees would be taxed currently on all employer benefit plan contributions, including pension, medical, and life insurance contributions. Under Scenario #2, employees would be taxed currently for all employer benefit plan contributions except pension contributions, which would be tax deferred until benefits are distributed (as under current law). Under Scenario #3 (Treasury's recommendation), employer medical plan contributions above $70 per month for single employees and $175 per month for families would be taxed currently, together with all imputed employer life insurance costs.

Treasury's recommendations for taxing employees on selected employer benefit plan contributions (Scenario #3) were submitted to the President in November 1984 as part of Treasury's overall proposal for reforming federal tax policy. At this writing, Treasury reportedly is considering, as an alternative to taxing employer medical contributions, imposing a tax on all employer contributions up to a specified dollar limit. Any employer medical contributions above this "floor" would continue to be excluded from tax.

We assumed in each of the three scenarios that employer contributions also would be taxed for Social Security purposes; in recent years, Congress has made many previously excluded sources of employee earnings subject to Social Security tax. Accordingly, we believe it is reasonable to assume that employer benefit plan contributions would be taxed for Social Security as well as federal income tax purposes.

Our principal findings show that:

- employees would pay the highest taxes under Scenario #1 because employee pension accruals for 1985 are included in taxable income, together with employer medical contributions and imputed employer life insurance costs.
- a tax on employer medical contributions under Scenarios #2 and 3 would worsen the existing inequity for married employees that is created by the premium structure of many medical plans.
- under Scenario #3, a married employee with a working spouse would receive less value from the employee's medical plan than an employee with a spouse who does not work in paid employment, but the two-income couple would pay higher taxes for those benefits.

The following report presents our results in detail and discusses problems that would arise from changing the tax treatment of certain benefit plans. We believe, for example, that:

- a tax on employer medical plan contributions eventually would increase substantially the cost of some employer-sponsored medical plans because of adverse selection.
- a tax on employer medical contributions also would discriminate against certain groups of employees because an employee's age, sex, family status, and geographic location have a significant bearing on the cost of medical benefits.

Furthermore, we believe there is a certain unfairness in using tax policy to promote the establishment of employer-sponsored benefit plans and then, once these plans are established and cover the majority of the work force, changing tax policy and removing the "carrot." If we assume that the present tax policy resulted in the development of employer-sponsored benefit plans that exist today, then it would be unreasonable to assume that a significantly different policy would be neutral and not influence employer-employee decisions about benefits, including existing benefits. It is only reasonable to assume that employers, confronted with a new tax policy, would make decisions consistent with that new policy and not the old policy; previous benefit decisions would be reversed and the present employer-sponsored benefit system dismantled to the extent it is inconsistent with new tax policy.

There seems to be a misconception among some policymakers that employee benefits are provided only to highly compensated employees. The term "fringe" benefits, often used to describe employer-sponsored benefit plans, understates the importance of these plans in providing essential income security protection to employees and their families in all income brackets.

We believe that major changes in current employee benefit tax policy would weaken this employer-based approach to individual financial security. We recommend that Congress look beyond misconceptions about employer-sponsored benefit plans in evaluating the appropriateness of current employee benefit tax policy and proposed changes thereto. Employer-sponsored plans need to be evaluated in terms of the critical roles these plans play in meeting the needs of employees, employers, and the economy and in precluding the need for larger government-sponsored social insurance programs and correspondingly higher taxes.

SECTION I

INTRODUCTION

The American Federation of State, County and Municipal Employees (AFSCME) retained William M. Mercer-Meidinger, Incorporated to determine the extent to which certain changes in employee benefit tax rules would affect state and local government employees. Specifically, this study estimates the increase in federal income and Social Security tax that public employees would pay under current tax rates if employer contributions to certain employee benefit plans were taxed.

This report:

- presents background information on the growth and development of employee benefit plans (Section II).
- describes the method used in our study and presents our findings (Section III).
- discusses some key policy considerations that need to be addressed in evaluating the appropriateness of changing current benefit tax policy (Section IV).

Our analysis stresses the many roles that employer-sponsored plans play in meeting the varied needs of employees, employers, and the economy.

SECTION II

OVERVIEW OF EMPLOYER-SPONSORED BENEFITS

Purpose of Employee Benefit Plans

Employer-sponsored benefit plans are an important source of economic security for American workers. These plans provide employees and their families with financial security when death, disability or illness strikes and when employees retire. They also help employers to compete effectively in the labor marketplace for qualified employees, attract and retain valuable employees, encourage employee loyalty, build employee morale, and increase employee productivity. The existence of employer-sponsored plans also reduces the need for increased benefits under federal social insurance programs, which would be supported by increased taxes.

Coverage and Distribution of Benefits

The term "fringe" benefits, often used in referring to employer-sponsored benefit plans, understates the importance of these plans in providing basic income security protection to employees and their families in all income brackets.

The four basics — medical, life insurance, long-term disability and pension benefits — are not reserved for the very wealthy; they are designed to cover all regular employees, regardless of salary. A 1983 Bureau of Labor Statistics (BLS) study of employee benefits in medium and large private organizations (i.e., firms with 250 employees or more) found that 96 percent of full-time employees are covered under employer-sponsored medical and life insurance plans and 82 percent under pension plans. Forty-five percent of employees were covered by employer-sponsored long-term disability insurance plans and 66 percent were covered by disability provisions of pension plans that enable qualifying employees to receive an immediate disability pension.[1]

Preliminary data released by the Employee Benefit Research Institute (EBRI) show the percentage of employees who are covered by pension and medical plans on an industry-by-industry basis. About 90 percent of public sector employees are covered by pension and medical plans. Other surveyed industries that have high employer pension and medical plan participation rates include manufacturing, public utilities, real estate, finance and insurance, and communications.[2]

Employer-sponsored benefit plans cover employees across all salary levels. Over 80 percent of all nonagricultural employees, including most employees represented by AFSCME, earn salaries that are under $25,000 per year. Pension plan coverage and vesting of pension plan benefits follow this same pattern. EBRI data show that 76 percent of those employees who are covered by pension plans and 70 percent of those employees who have vested pensions earn less than $25,000 per year. Employer-sponsored medical plans have given employees and their dependents, regardless of income, affordable access to expensive medical care services. Over 80 percent of employees covered by employer medical plans in 1982 earned less than $30,000; 53 percent earned less than $15,000; only 5 percent earned salaries that exceeded $40,000.[3]

---

[1] U.S. Bureau of Labor Statistics, Employee Benefits in Medium and Large Firms, 1983, August 1984, pp. 2-5.

[2] EBRI Issue Brief, December 1984, p. 2. Percentages reflect coverage of employees who were at least age 25 with one year of service (ERISA's original minimum participation standard for private pension plans).

EBRI tabulations of the Battelle Survey of Employment-Related Health Benefits in Private, Non-Farm Business Establishments and BLS' 1980 Level of Benefits Survey show that 83 percent of all regular employees participate in employer-sponsored medical plans; significantly, 58 percent of those employees work for employers with a work force of under 250.[4]

There seems to be a misconception among some policymakers that employee benefits are provided only to highly compensated employees. We believe that major changes in current employee benefit tax policy would weaken this private approach to employee income security, which provides essential financial protection to the vast majority of American workers.[5]

State and Local Government Plans

Most of the 13 million employees in state and local government are covered on a automatic basis by the four basics — medical, life insurance, long-term disability, and pension benefits. Employees and employers usually share the cost of these benefits; employee contributions are made from after-tax income. In contrast, the majority of employer-sponsored plans in the private sector have been made available on a noncontributory basis, although recently more private employers have begun to require employees to contribute.

---

[3] EBRI Issue Brief, November 1984, pp. 2-4.

[4] Deborah J. Challot, Employer-Provided Health Benefits (Washington, D.C.: EBRI, 1984) pp. 32-34.

[5] Private approach refers to public and private employer-sponsored benefits in contrast to statutory social insurance programs, such as Social Security.

Some public sector benefit plans were established several decades before private sector plans began to flourish in the 1940s and 1950s; others were established during the 1930s, just before or soon after Social Security was enacted in 1935. However, most public pension were not established until the 1940s and 1950s, when private employers established their plans.

Public pension plans typically provide retirement benefits to eligible employees, disability income for employees who are permanently and totally disabled, and survivor income (death benefits) for dependents of employees who die during active employment or after retirement. Group term life insurance plans pay a death benefit to designated beneficiaries as a supplement to survivor income benefits provided by employer-sponsored pension plans. When survivors are not eligible for pension death benefits because a deceased employee did not complete sufficient service with the employer, life insurance is the only source of employer-sponsored survivor benefits.

State and local government medical plans provide public employees and their dependents with access to an otherwise prohibitively expensive health care delivery system. Coverage varies from one plan to another. Some plans offer comprehensive health care protection; others offer lower coverage. Most plans provide protection against catastrophic illness, although the maximum limits of catastrophic coverage can vary significantly.

About 70 percent of state and local government employees are covered by Social Security, which provides significant retirement, disability, survivor, and postretirement medical care benefits to covered employees and their dependents. Where public employers do not participate in Social Security, employer-sponsored benefit plans are the most important source of retirement, disability, survivor, and postretirement medical protection for public employees.

Over the past two decades, many public employers have broadened the scope of benefits beyond the four basics. For example some employees also are covered by prescription drug, vision care, and dental plans, which supplement employer-sponsored medical plans.

Role of the Internal Revenue Code

Employee benefit plans have been strongly influenced by the Internal Revenue Code. The Tax Code grants employees special tax treatment for employer benefit plan contributions and for their own contributions to certain employer-sponsored plans. For example, employees do not pay income tax for employer contributions to pension plans until benefits are distributed. If pension benefits are distributed as a lump sum, retirees are granted ten-year forward averaging so that the lump-sum payment is taxed at more favorable rates upon distribution. Employer contributions to medical plans are not imputed as taxable income to employees, nor are employer contributions to group term life insurance plans for coverage of under $50,000. Private employers may deduct their benefit plan contributions if their plans meet specific Internal Revenue Code requirements.

Current employee benefit tax policy has proven to be beneficial to employees, employers, and the U.S. economy. These tax rules were not set up as tax-avoidance schemes, but as a vehicle for achieving important social and economic objectives. The Tax Code has been a catalyst for:

- o strengthening the employee-employer relationship.
- o advancing the development of the private approach to providing economic security to employees and their families.
- o improving the overall health of the American work force through affordable access to quality medical care.
- o promoting individual savings and retirement security through pension plans and more recently through capital accumulation and deferred compensation plans.
- o redistributing savings and employer contributions among income groups through the Tax Code's antidiscrimination rules, which prohibit qualified pension plans and certain other employer-sponsored savings arrangements from discriminating in favor of highly compensated employees.
- o enabling pension plans to become the largest institutional investor in this country and a major force in promoting economic growth through capital development.

Proposed Changes in Employee Benefit Tax Policy

Because of its success in encouraging employers to establish employee benefit plans, current benefit tax policy has come under close scrutiny by the

Administration and Congress. Over the past several years, numerous proposals have been advanced to repeal or modify significantly present tax treatment of employee benefit plans. In November 1984 the U.S. Treasury Department submitted a detailed report to the President that recommends major changes in benefit tax policy. 6

Treasury's recommendations would affect virtually every type of employer-sponsored benefit plan. For example, these recommendations would repeal the current exclusion from taxation on the following employee benefits:

- o employer contributions to medical plans above a tax exempt limit of $70 per month for single employees and $175 per month for families.
- o imputed employer costs for group term life insurance coverage of under $50,000.
- o employer-sponsored death benefits.
- o employer-sponsored educational assistance and group legal services which, under current law, are tax exempt through 1985.

Treasury also recommends taxing unemployment compensation beyond present statutory limits and tax-exempt workers' compensation benefits.

---

6. Office of the Secretary, U.S. Department of Treasury, Tax Reform for Fairness, Simplicity, and Economic Growth, Volume II of the Treasury Department Report to the President, November 1984.

At this writing, Treasury reportedly is considering, as an alternative to the above proposal for taxing employer medical contributions, imposing a tax on employer contributions up to a specified dollar limit. Any payments above this "floor" would continue to be tax exempt.[7]

Proposals for changing employee benefit tax policy are part of a larger effort to restructure and simplify the entire tax system. The underlying premise of Treasury's recommendations is that a broadened tax base and compressed tax rate structure would enable businesses and individuals to make economic decisions that are not influenced by employee benefit tax rules that exist in the Tax Code. Treasury's recommendations for changing employee benefit tax policy also are designed to meet this objective partly by eliminating or modifying current tax treatment of employer benefit plan contributions.

These recommendations are designed to meet other important objectives as well. For example, Treasury suggests that a tax on certain employer benefit plan contributions would contain health care costs by eliminating overconsumption of medical care services by employees who are covered under comprehensive medical plans and who currently receive those benefits tax free. It would also eliminate the current "government subsidy" of employer-sponsored benefits so that employees who are covered by these plans pay the cost of these plans in after-tax dollars, as employees who are not covered by benefit plans must do in purchasing this protection on an individual basis.[8]

---

7. Jeffrey H. Birnbaum and Paul Blustein, "Treasury Likely to Ease Stance on Pension Tax," The Wall Street Journal, May 1, 1985.

8. U.S. Treasury, Tax Reform for Fairness, Simplicity, and Economic Growth, pp. 20-22.

The perception of employer-sponsored benefit plans portrayed in Treasury's report to the President overlooks the role that these plans play in providing basic financial protection to the vast majority of American workers.

If Treasury's recommendations are enacted, many employees would be affected adversely, particularly those in low and moderate income brackets. Using current tax rates, our study shows that employees would pay higher income tax and higher Social Security tax. Regardless of the tax rates used, however, it is clear that a flat-dollar, tax-exempt cap on employer medical contributions would lead to adverse selection in many employer-sponsored medical plans -- many healthy employees would drop their coverage or seek lower-cost coverage, and the cost of providing comprehensive coverage to the higher risks who remain eventually would become prohibitive. Further discussion of specific aspects of Treasury's employee benefit recommendations appears in Section IV of this report.

SECTION III

MERCER-MEIDINGER STUDY

Method

We developed a computer model to quantify the effect of taxing state and local government employees for employer benefit plan contributions. Three tax-change scenarios were examined using current income tax rates.

Each scenario assumes that employer contributions would be subject to Social Security tax as well as federal income tax. This would be consistent with recent Congressional action to tax employee income that was previously exempt from Social Security payroll tax, especially if the income is taxable for federal income tax purposes. In 1985, employers and employees each pay Social Security tax of 7.05 percent of employee salary up to a maximum of $39,600.

Scenario #1: Employees would be currently taxed on employer contributions for all plans that presently receive special tax treatment. These include employer contributions for pension, life insurance, medical (health insurance), dental, prescription drugs, and vision care benefits.

Scenario #2: Employees would be currently taxed as in Scenario #1, except for employer pension plan contributions, which would be tax deferred until benefits are distributed (as under current benefit tax rules).

Scenario #3: Employees would be taxed currently only on employer contributions for medical plan contributions above a tax-exempt cap of $70 per month for single employees and $175 per month for a family. Employees also are taxed on all imputed employer costs for group term life insurance coverage. (This scenario closely follows Treasury's proposal for including selected employer benefit plan contributions as employee taxable income.)

Assumptions used in developing Mercer-Meidinger's computer model are presented in Appendix A.

The computer model quantified the tax effect under each of these scenarios on hypothetical employees who work for the following public employers: University of California, Cook County (Illinois), Milwaukee County (Wisconsin), State of Michigan, Nassau County (New York), and Prince Georges County (Maryland).

AFSCME selected these public employers because they provide employee benefit plans that are representative of benefit plans sponsored by other major public employers. Employee benefit data used in the model were supplied and verified by AFSCME and are presented in Appendix B. The data reflect benefit plan provisions and contributions that were in effect during February 1985.

Employees used in the model are age 45 and will have completed 15 years of employment by the end of 1985. They earn salaries of $15,000, $20,000, and $25,000, which are representative of salaries paid to typical AFSCME members. In the State of Michigan, for example, a word processor, psychiatric aide, and nurse's aide with 15 years of service earn approximately $15,000 per year; a dietician and an accountant respectively earn approximately $20,000 and $25,000 per year. A representative list of job titles that match these salary levels for the surveyed employers appears in Appendix C.

Our findings show the tax increase under each scenario for employees in seven situations:

- single employee, $15,000 annual salary, no dependent children.
- single employee, $20,000 annual salary, no dependent children.
- married employee, $20,000 annual salary, no dependent children, working spouse with $15,000 annual salary.
- married employee, $20,000 annual salary, two dependent children, working spouse with $15,000 annual salary.
- single employee, $25,000 annual salary, no dependent children.
- married employee, $25,000 annual salary, no dependent children, spouse does not work.
- married employee, $25,000 annual salary, no dependent children, working spouse with $20,000 annual salary.

Findings

The results of our study are summarized in Tables I, II, and III respectively for Scenarios #1, 2, and 3. The details of our findings are presented in Appendix D. Charts I through VI display our results for Scenario #3 in graph form.

We find that:

- The increase in federal income and Social Security tax combined, expressed as a percentage of gross salary, ranges from a low of 1.8 percent to a high of 8.8 percent under Scenario #1, 1.6 percent to 7.8 percent under Scenario #2, 0.5 percent to 4.5 percent under Scenario #3.[9]

- Employees pay the highest tax increase under Scenario #1 because employee pension accruals for 1985 are included in taxable income, together with employer medical contributions and imputed employers life insurance costs.

- There is a direct corelation between the wide range of tax increases under Scenarios #2 and 3 and the age, sex, family status, and geographic location of individual employees.

- The premium structure of group medical plans is not related directly to the age of individual employees. If it were, our results would show that premiums increase with age and that a tax on employer medical contributions in Scenarios #1,2 and 3 would not take this into account.

- With the exception of the State of Michigan, Charts I through VI for Scenario #3 show that the premium structure in the surveyed medical plans creates an inequity for married employees who do not have dependent children, and this inequity is worsened by a tax on employer medical contributions.

---

[9] Premiums for medical insurance are "medical expenses" just as surely as if benefits were self insured and the employee incurred "medical expenses." As such, they should be deductible from Adjusted Gross Income (AGI) along with other "medical expenses" to the extent they exceed 5 percent of AGI. If true, the net increase in taxes would be affected. Our calculations do not take this into account.

The charts show, for example, that a married employee who earns $20,000, has no dependent children and has a working spouse who earns $15,000, pays higher taxes on employer medical contributions than if the couple had two dependent children. This is because the premium structure of these plans distinquishes only between individual and family coverage and not between married employees with and without dependent children. Thus, employer contributions for all married couples, regardless of the number of family members, is the same except in the State of Michigan plan, where contributions differ between married employees with and without dependent children. The tax on employer medical contributions in Scenario #3 does not account for this inequity; thus, an employee with a working spouse and no dependent children pays a higher tax on employer contributions than those who have dependent children.

- A married employee with a working spouse pays higher taxes on employer medical contributions under Scenario #3 than otherwise would be paid if the spouse did not work in paid employment because the tax is based on the combined income of the two-earner couple. If the working spouse also is covered under an employer-sponsored plan, that plan would be the primary payer for the spouse and the employee's plan would be secondary. Thus, the total value of benefits under the employee's plan would be lower for the two-income couple than for a married employee whose spouse does not work, but the two-income couple would pay higher taxes for those benefits.

Commentary

We deliberately used a conservative approach in testing the tax effect of each scenario. The tax increases would have been higher if we had considered the tax increase resulting from state and local income tax on employer contributions. Furthermore, if we had estimated the increase in taxable income resulting from the spouse's employer's benefit plan contributions, we expect that the tax increases shown for the two-earner couple could double.[10]

---

[10] We did not consider the effect of taxing both the employee's and working spouse's employer benefit plan contributions because the assumptions that need to be made are beyond the scope of this study. We did make one estimate under Scenario #3 for a married employee of the State of Michigan who earns $30,000 in 1985, has two dependent children, and a working spouse, also age 45, who earns $30,000 for a large private employer. We assumed that the working spouse receives employer-paid term life insurance coverage of two times salary and the employer contributes $250 per month for family medical and dental coverage. (These assumptions are considered to be within the usual pattern of private sector plans.) Based on these assumptions, we estimated that total Social Security and income tax paid on the employee's and spouse's employer benefit plan contributions for 1985 would be $1,278, approximately double the estimated tax increase attributed to employer benefit plan contributions made on behalf of the employee.

TABLE I

SCENARIO 01

TAX ALL EMPLOYER CONTRIBUTIONS FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES

SITUATION:

	MARITAL STATUS:	SINGLE		SINGLE		MARRIED		MARRIED		SINGLE		MARRIED		MARRIED	
	EMPLOYEE SALARY:	$15,000		$20,000		$20,000		$20,000		$25,000		$25,000		$25,000	
	WORKING SPOUSE SALARY:	N/A		N/A		$15,000		$15,000		N/A		N/A		$20,000	
PUBLIC EMPLOYER	DEPENDENT CHILDREN:	N/A		N/A		0		2		N/A		0		0	
		TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.
UNIVERSITY OF CALIFORNIA		$487	3.2%	$590	3.0%	$1,613	8.1%	$1,462	7.3%	$670	2.7%	$1,283	5.1%	$1,795	7.2%
COOK COUNTY		310	2.1%	399	2.0%	816	4.1%	718	3.6%	453	1.8%	589	2.4%	917	3.7%
MILWAUKEE COUNTY		715	4.8%	998	5.0%	1751	8.8%	1587	7.9%	1254	5.0%	1369	5.5%	2081	8.3%
STATE OF MICHIGAN		612	4.1%	837	4.2%	1386	6.9%	1559	7.8%	1035	4.1%	1169	4.7%	1636	6.5%
NASSAU COUNTY		806	5.4%	1160	5.8%	1703	8.5%	1544	7.7%	1506	6.0%	1499	6.0%	2097	8.4%
PRINCE GEORGES COUNTY		291	1.9%	422	2.1%	991	5.0%	898	4.5%	545	2.2%	835	3.3%	1169	4.7%

TABLE II

SCENARIO 02

TAX ALL EMPLOYER CONTRIBUTIONS FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES

SITUATION:

PUBLIC EMPLOYER	MARITAL STATUS: EMPLOYEE SALARY: WORKING SPOUSE SALARY: DEPENDENT CHILDREN:	SINGLE $15,000 N/A N/A		SINGLE $20,000 N/A N/A		MARRIED $20,000 $15,000 0		MARRIED $20,000 $15,000 2		SINGLE $25,000 N/A N/A		MARRIED $25,000 N/A 0		MARRIED $25,000 $20,000 0	
		TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.
UNIVERSITY OF CALIFORNIA		$457	3.0%	$540	2.7%	$1,360	7.0%	$1,421	7.1%	$602	2.4%	$1,225	4.9%	$1,716	6.9%
COOK COUNTY		305	2.0%	390	2.0%	807	4.0%	710	3.6%	441	1.8%	581	2.3%	904	3.6%
MILWAUKEE COUNTY		357	2.4%	429	2.1%	1144	5.7%	1037	5.2%	471	1.9%	823	3.3%	1251	5.0%
STATE OF MICHIGAN		379	2.5%	465	2.3%	980	4.9%	1199	6.0%	523	2.1%	781	3.1%	1093	4.4%
OAKLAND COUNTY		304	2.0%	364	1.8%	845	4.2%	766	3.8%	401	1.6%	661	2.6%	925	3.7%
PRINCE GEORGES COUNTY		279	1.9%	346	1.7%	909	4.5%	824	4.1%	392	1.6%	719	2.9%	1006	4.0%

TABLE III

SCENARIO 03

TAX ALL EMPLOYER CONTRIBUTIONS ABOVE MEDICAL CAP AND EMPLOYER CONTRIBUTIONS FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES

SITUATION:

PUBLIC EMPLOYER		SINGLE		SINGLE		MARRIED		MARRIED		SINGLE		MARRIED		MARRIED	
	MARITAL STATUS:	SINGLE		SINGLE		MARRIED		MARRIED		SINGLE		MARRIED		MARRIED	
	EMPLOYEE SALARY:	$15,000		$20,000		$20,000		$20,000		$25,000		$25,000		$25,000	
	WORKING SPOUSE SALARY:	N/A		N/A		$15,000		$15,000		N/A		N/A		$20,000	
	DEPENDENT CHILDREN:	N/A		N/A		0		2		N/A		0		0	
		TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.	TAX INCREASE	PERCENT OF SAL.
UNIVERSITY OF CALIFORNIA		$246	1.6%	$295	1.5%	$895	4.5%	$811	4.1%	$325	1.3%	$699	2.8%	$978	3.9%
COOK COUNTY		154	1.0%	197	1.0%	282	1.4%	248	1.2%	223	0.9%	203	0.8%	316	1.3%
DELAWARE COUNTY		147	1.0%	176	0.9%	471	2.4%	427	2.1%	194	0.8%	339	1.4%	515	2.1%
STATE OF MICHIGAN		168	1.1%	212	1.1%	315	1.6%	589	2.9%	245	1.0%	255	1.0%	357	1.4%
MADISON COUNTY		93	0.6%	112	0.6%	172	0.9%	136	0.7%	123	0.5%	135	0.5%	189	0.8%
PRINCE GEORGES COUNTY		69	0.5%	93	0.5%	236	1.2%	214	1.1%	114	0.5%	193	0.8%	270	1.1%

CHART I

ESTIMATED 1985 SOCIAL SECURITY AND FEDERAL INCOME TAX INCREASE FOR UNIVERSITY OF CALIFORNIA EMPLOYEES UNDER SCENARIO #3

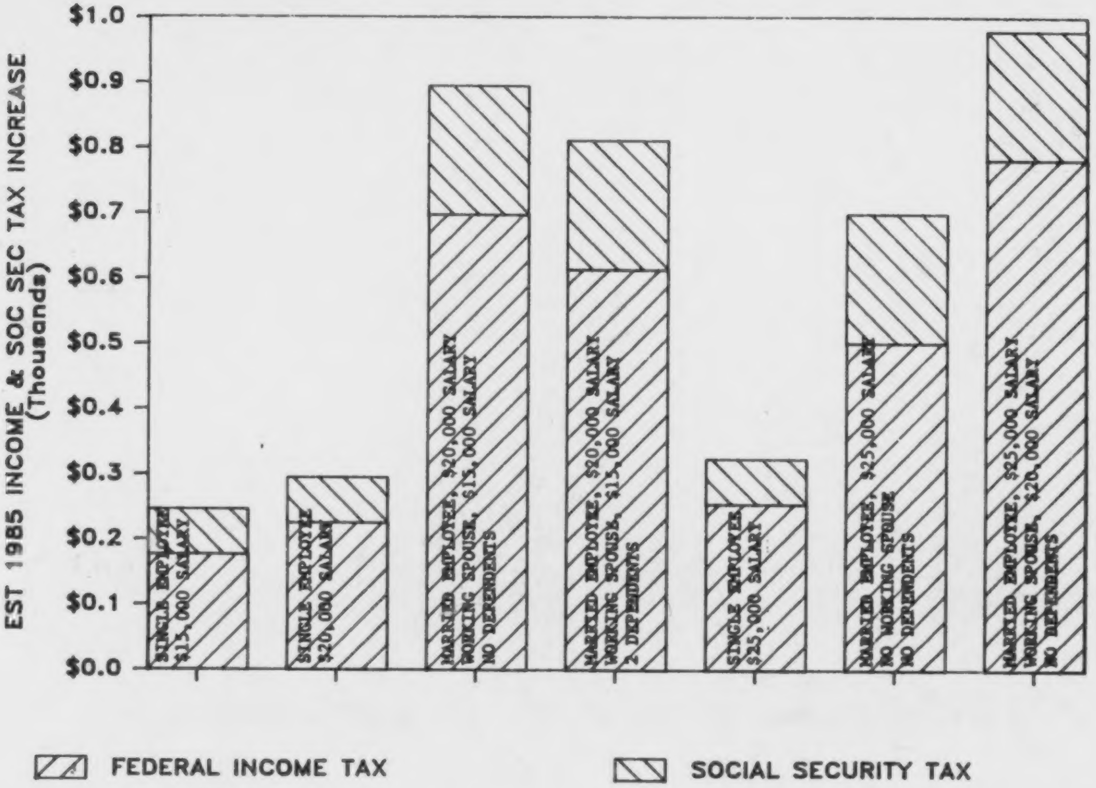
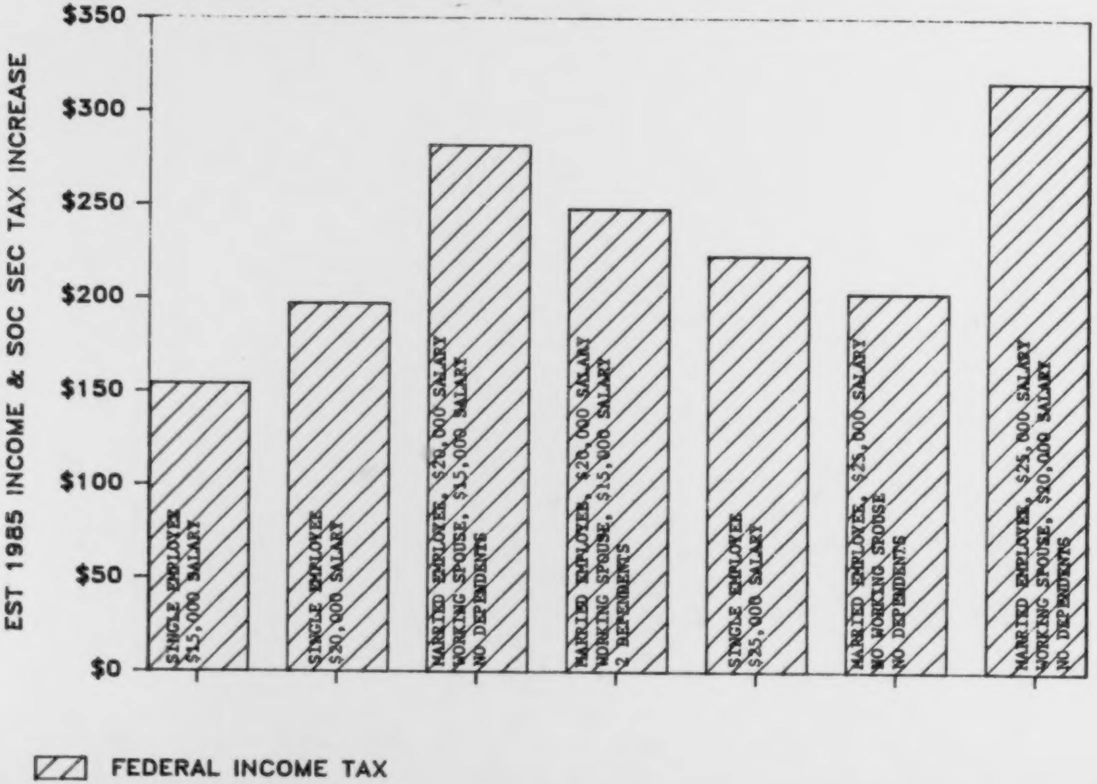


CHART II

ESTIMATED 1985 FEDERAL INCOME TAX INCREASE FOR COOK COUNTY EMPLOYEES UNDER SCENARIO #3*



* NO SOCIAL SECURITY COVERAGE

CHART III

ESTIMATED 1985 SOCIAL SECURITY AND FEDERAL INCOME TAX INCREASE FOR MILWAUKEE COUNTY EMPLOYEES UNDER SCENARIO #3

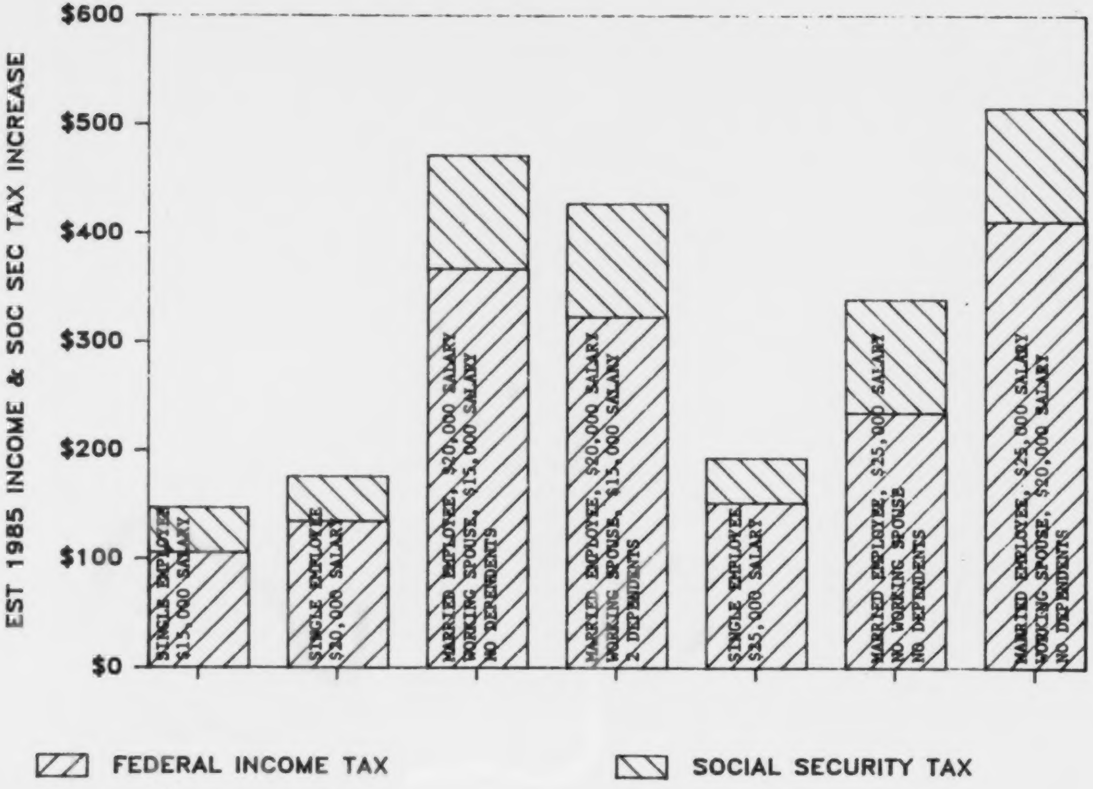


CHART IV

ESTIMATED 1985 SOCIAL SECURITY AND FEDERAL INCOME TAX INCREASE FOR THE STATE OF MICHIGAN EMPLOYEES UNDER SCENARIO #3

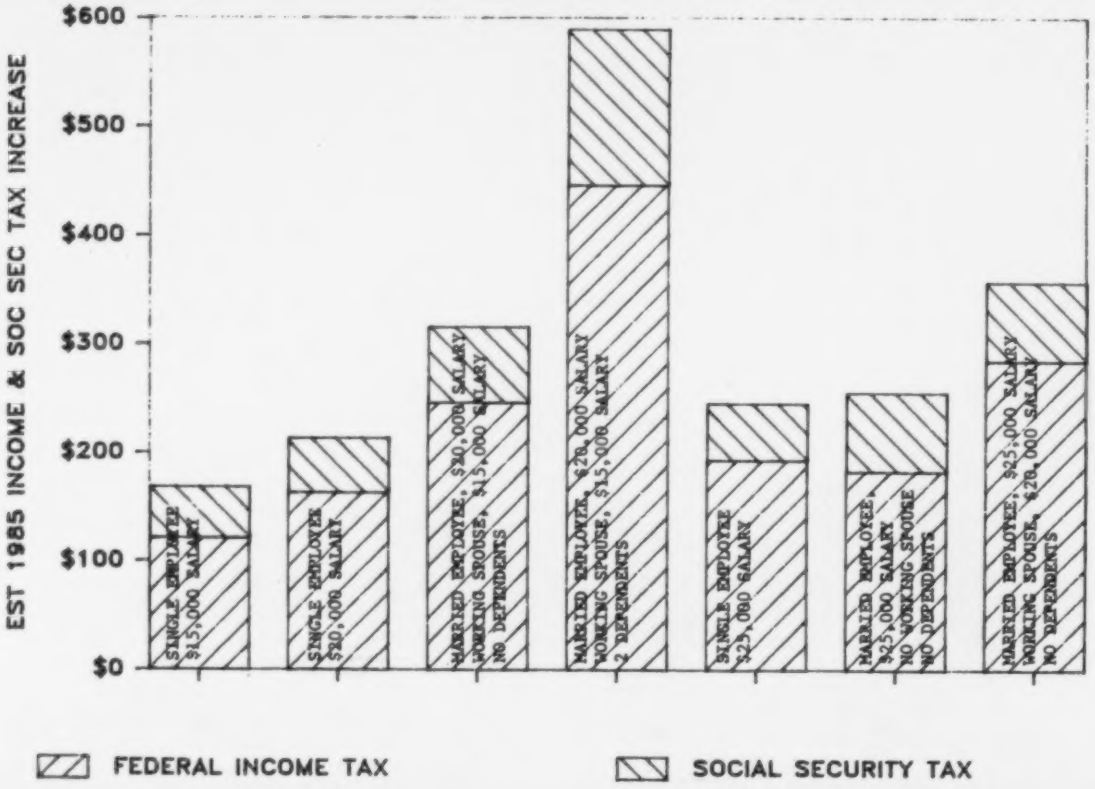
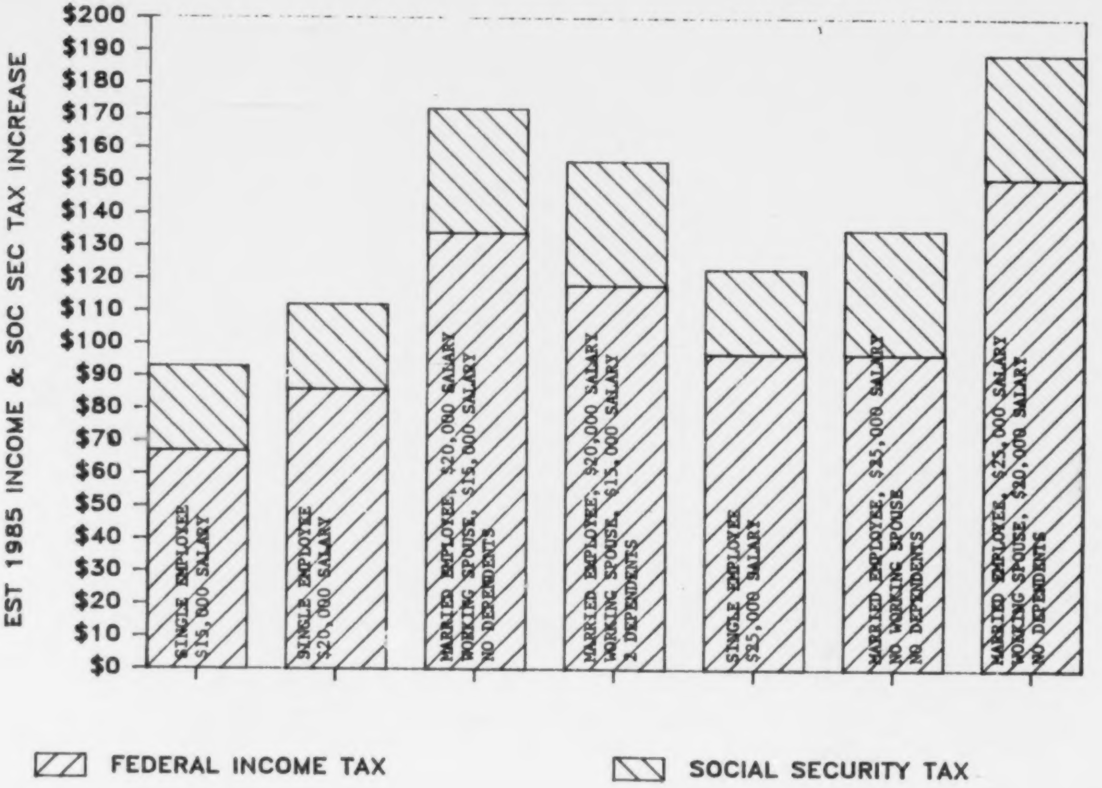


CHART V

ESTIMATED 1985 SOCIAL SECURITY AND FEDERAL INCOME TAX INCREASE FOR NASSAU COUNTY EMPLOYEES UNDER SCENARIO #3



SECTION IV

POLICY CONSIDERATIONS

Introduction

The view that the special tax rules for employee benefit plans are tax-avoidance mechanisms designed for highly compensated employees or that they are in-kind subsidies to employees overlooks the reasons that these plans were established, the purposes they serve today, and the fact that these plans cover employees at all salary levels.

Employer-sponsored benefit plans of the 1980s:

- provide essential economic security for American workers and their families that otherwise probably would have been provided through an expanded Social Security system and a national health insurance system.
- encourage individual savings through pension plans and other permitted savings arrangements.
- contribute to this country's economic growth through investment of public and private sector pension fund assets in U.S. capital markets.

The Tax Code has been a catalyst for achieving these objectives.

Current employee benefit tax policy and proposed changes thereto need to be evaluated in these terms if sound policy decisions are to be made.

Section IV discusses the appropriateness of changing certain aspects of employee benefit tax policy and likely employer and employee reaction to such changes.

Medical benefits

A. Reasons for Taxing Employer Contributions

A number of proposals that recommend taxing employees for employer medical plan contributions set a limit on the amount of employer contributions that would remain tax exempt. Any contribution above this limit would be taxed as ordinary income. Treasury recommends that the tax-exempt limit be set at $70 per month for single employees and $175 per month for a family.

Treasury contends, for example, that the current tax exclusion of employer medical contributions:

- results in unfair treatment of employees who are not covered by employer-sponsored plans and must purchase individual coverage with after-tax dollars; and
- encourages overconsumption of health care services and contributes to the spiralling cost of medical are.

Treasury explains in its Report to the President that:

> The spiralling costs of health care in recent years may be attributable in significant part to overconsumption of health care by employees for whom such care is not only tax free but, in many cases, available without limit. The costs of such price distortions are distributed throughout the economy and affect all taxpayers. They fall most cruelly upon those who do not receive employer-provided health care and other fringe benefits but must pay for such services out of their own pockets.[11]

---

[11] U.S. Treasury Department, Tax Reform for Fairness, Simplicity, and Economic Growth, p. 21.

1. Fairness of Current Tax Treatment

Treasury recognizes that the current policy of exempting employer medical contributions "within limits... is an appropriate part of the national policy to encourage essential health care services," and, therefore, recommends imposing a tax-exempt cap on employer medical contributions rather than repealing the tax exclusion altogether. 12 In so doing, the tax-exempt cap does not resolve Treasury's first objection about current policy; that current policy enables some taxpayers to receive disproportionately high medical benefits and others, who are not covered by employer-sponsored plans, to pay for coverage out of pocket in after-tax dollars. This situation will not be corrected by imposing a tax cap; other, more specific measures would be needed to remedy this situtation, such as allowing a tax deduction for medical premiums paid entirely by individuals with after-tax dollars.

2. Current Tax Treatment and Medical Price Inflation

Over the past year previously unremitting inflation in the health care industry has risen at a slower rate than anytime in recent years, notwithstanding the current tax exemption of employer medical plan contributions.

Table IV and Chart VII compare the annual increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) for all items with the Medical Care Component of the CPI-W from 1978 through 1984.

---

12. U.S. Treasury Department, Tax Reform for Fairness, Simplicity and Economic Growth, p. 23.

These figures show that the medical price inflation rate moderated in 1983 and 1984 in comparison with the three previous years (although medical prices still increased 1.6 times faster in 1984 than general inflation).

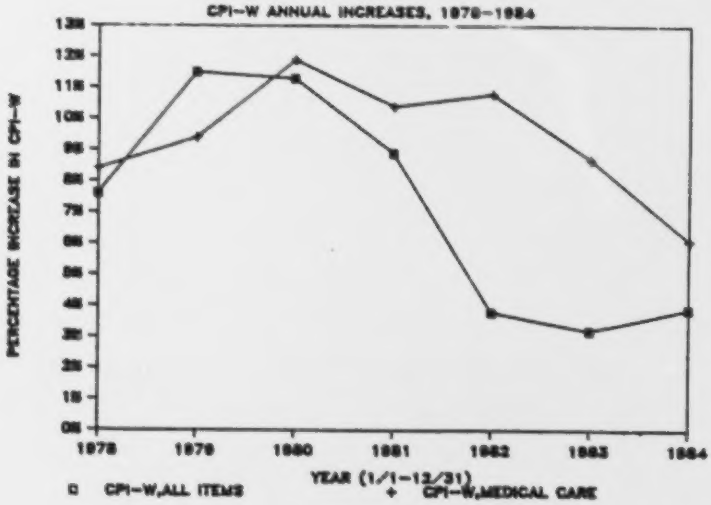
TABLE IV

Consumer Price Index (CPI-W) Annual Increases, 1978-1984

Change from 1/1 to 12/31	Consumer Price Index (All Items)	Medical Care Component of Consumer Price Index
1978	7.6%	8.4%
1979	11.5	9.4
1980	11.3	11.9
1981	8.9	10.4
1982	3.8	10.8
1983	3.2	8.7
1984	3.9	6.1

Source: U.S. Bureau of Labor Statistics

CHART VII



Employers and unions recognize the serious effects that medical price inflation has had on employees and on the cost of doing business. Many employers, with union cooperation, have implemented cost containment measures in their medical plans. A Bureau of National Affairs Survey, for example, shows that 81 percent of responding firms indicated that they have recently taken steps to control plan costs or were planning to do so in the near future.[13]

Recent hospital statistics show encouraging results. According to the American Hospital Association, hospital admissions declined from 36.3 million in 1983 to 35 million in 1984 and the average length of hospital stay was 6.1 days in 1984, a 5 percent reduction over 1983 results. Hospital occupancy also declined from 1983 to 1984 by 7.8 percent to 66.6 percent, the lowest overall rate since 1963.[14] These results can be attributed to such factors as implementation of employer-employee cost containment measures and Medicare's prospective payment system, among other factors.

Imposing a tax cap on employer medical plan contributions would encourage good risks (i.e., healthy people) to move into less costly plans to avoid paying tax on employer contributions. Those employees who expect to gain from remaining in the plan (employees who expect to use the plan's benefits) will stay enrolled. Eventually, the cost of many comprehensive plans will increase substantially because of adverse selection. Employers then will have to decide whether to absorb the increase, pass it on to employees enrolled in comprehensive plans, reduce benefits, or terminate the plan and force high risk employees into plans that offer lower coverage.

---

[13] Bureau of National Affairs, Inc., Health and Life Insurance Benefit Plans, PPF Survey No. 137, March 1984, pp. 28-31.

[14] Ronald Sullivan, "Decline in Hospital Use Tied to New U.S. Policies", The New York Times, April 16, 1985 and "Third Quarter Hospital Trends...at a Glance," published by American Hospital Association, December 1984.

B. Differences in Medical Plan Costs

Differences in age, sex, family status, and geographic concentrations of employees produce significant variations in the cost of employer-sponsored medical plans. Thus, the cost of medical benefits in Mississippi is lower than the cost in California. Similarly, the cost of coverage within a particular plan differs between males and females and between employees in different age groups. These factors are not reflected in proposed flat dollar, tax-exempt limits on employer medical plan contributions or in proposals that would tax all employer medical contributions.

1. Age and Sex Differentials

Tables V and VI and Charts VIII and IX respectively present claim data for a West Coast employer and an East Coast HMO. The data in each case show the same results: average monthly claim costs vary significantly between different age groups and between the sexes.

TABLE V

Age and Sex-Based Differences in Claim Costs for a California - based Medical Plan

---

Average Monthly Claim Cost:

Active Employee Age	Male Employee	Female Emloyee
21-29	$29.38	$48.45
40-49	51.42	79.95
55-59	102.85	101.75
65-69	191.00	169.00

Source: William M. Mercer-Meidinger, Incorporated

CHART VIII

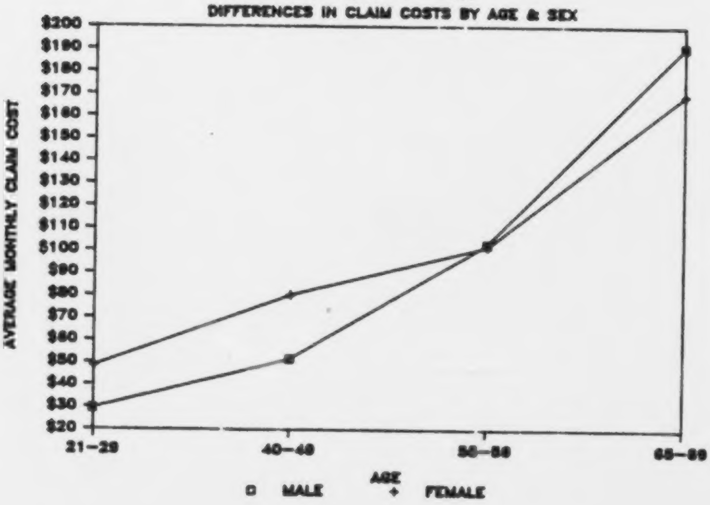

DIFFERENCES IN CLAIM COSTS BY AGE & SEX

Table V and Chart VIII show that claim costs increase each year by about 3 percent through age 30, 4 percent through age 40, 5 percent from age 40 to 50, and about 6 percent thereafter.

TABLE VI

Differences in HMO Claim Costs per Contract Year by Age and Sex: Inpatient and Outpatient Combined

(New York Blue Cross-Blue Shield Experience for 1978)

Age Group	Individual Male	Individual Female
20-29	$ 112.30	$ 169.02
30-39	$ 153.23	$ 240.02
40-44	$ 216.70	$ 312.29
45-49	$ 301.19	$ 374.90
50-54	$ 448.55	$ 400.79
55-59	$ 456.99	$ 473.29
60-64	$ 725.11	$ 587.43

Source: Malcolm Morrison and Anna Rappaport, The Costs of Employing older Workers (Washington, D.C.: EBRI and U.S. Special Committee on Aging, 1984) and Peter L. Hutchings and Richard E. Ullman, "Prepaid Hospital Care Age/Sex and Hospital Continuation Study", Transactions of the Society of Actuaries, Vol. XXXV, 1983.

CHART IX

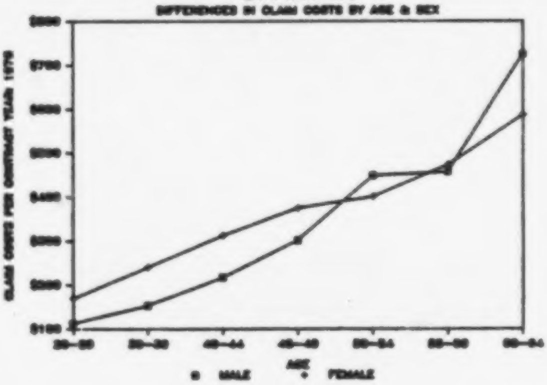


Table VII and Chart X present relative claim costs by age group. The index numbers were derived from HMO experience for families enrolled in group medical plans that was presented in the above-referenced study by Hutchings and Ullman.

TABLE VII

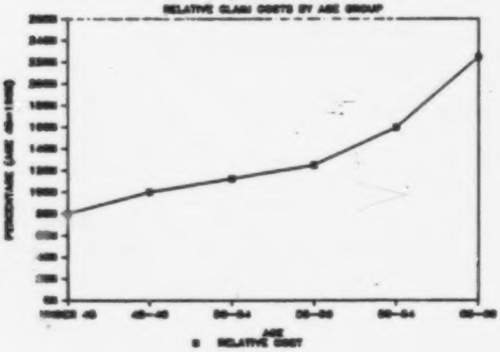
Relative Claim Cost by Age Group

(Age 45 = 100%)

Age	Relative Cost
Under 45	80%
45-49	100
50-54	112.5
55-59	125
60-64	160
65-69	225 (estimated)

Source: Morrison and Rappaport, The Costs of Employing Older Workers.

CHART X



The index numbers show that claim costs for employees under age 45 are 80 percent of the cost for a 45-year-old plan participant, rising thereafter with age.

2. Geographic Differences

Geographic location of employees has a significant impact on the cost of medical benefits. Table VIII, for example, shows the percentage difference between average claim costs throughout the State of California for a large employer-sponsored plan and the average cost for plan particpants in three specific California locations.

TABLE VIII

Variation in Average Claim Costs of a California-Based Medical Plan

Location	Percentage Deviation from Statewide Plan Average
Los Angeles/Orange	+27%
San Francisco/Oakland	+26
Sacramento	-11

Source: William M. Mercer-Meidinger, Incorporated.

Table VIII demonstrates that costs can vary significantly within the same plan from one location to another, in this case by as much as 40 percent. Plan participants located in Sacramento, which is in close proximity to the San Francisco/Oakland area, experience significantly lower average claim costs than plan participants in the San Francisco/Oakland and Los Angeles/Orange County metropolitan areas and plan participants throughout California.

Table IX and Chart XI show that the cost of medical benefits also varies significantly from one state to another.

CHART VI

ESTIMATED 1985 SOCIAL SECURITY AND FEDERAL INCOME TAX INCREASE FOR PRINCE GEORGES COUNTY EMPLOYEES UNDER SCENARIO #3

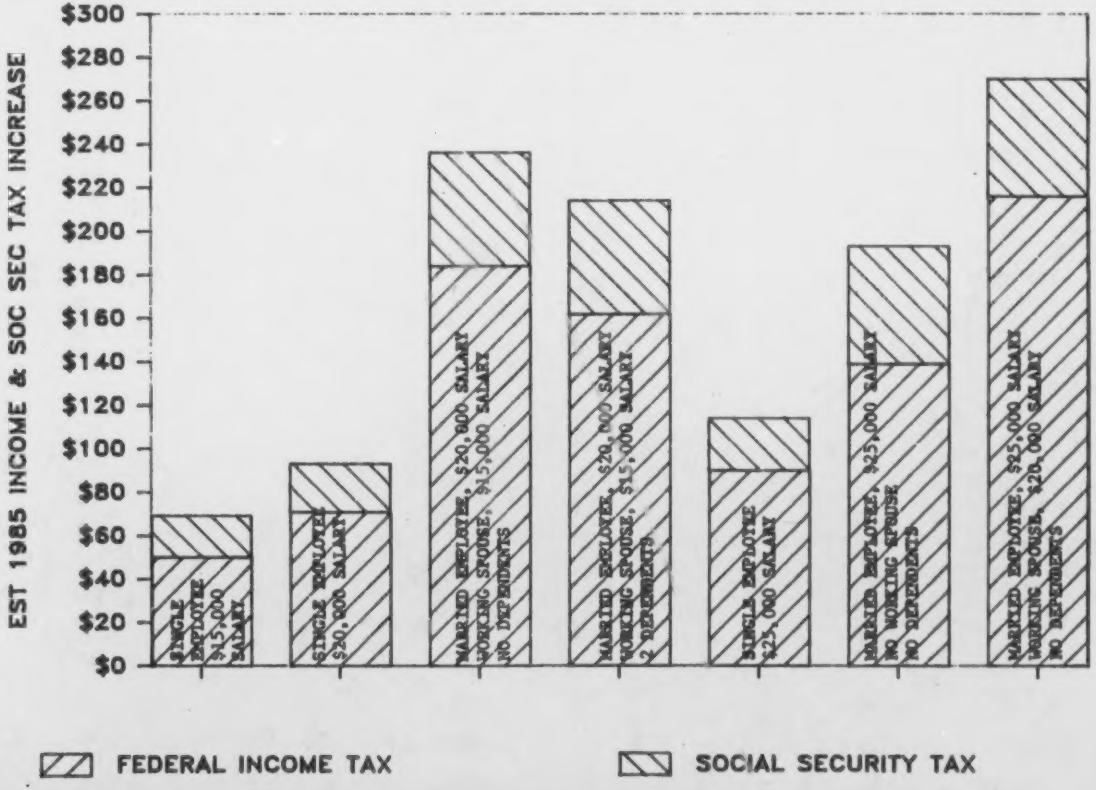


TABLE IX

Relative Index of Statewide Average Hospital Room and Board Charges in 1984

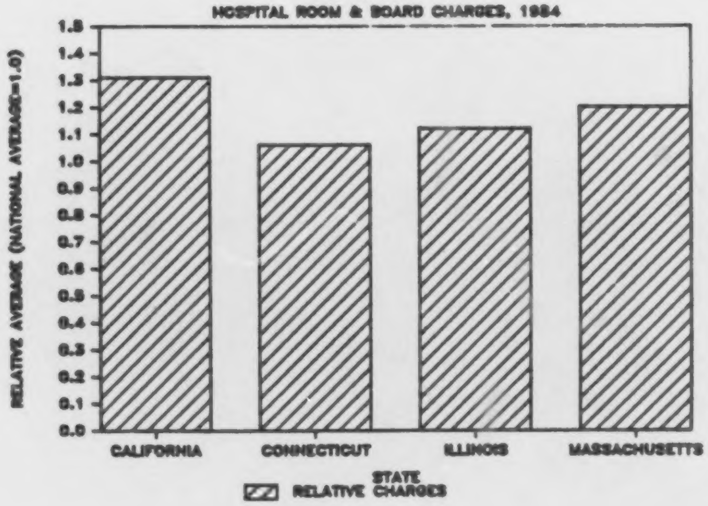
(National Average = 1.00)

State	Relative Average Hospital Room and Board Charges
California	1.31
Connecticut	1.06
Illinois	1.12
Massachusetts	1.20

Source: William M. Mercer-Meidinger, Incorporated.

CHART XI

HOSPITAL ROOM & BOARD CHARGES, 1984



The data show that the average hospital room and board charge in California is 31 percent above the national average, in Connecticut it exceeds the national average by only 6 percent, in Illinois by 12 percent, and in Massachusetts by 20 percent. These geographic differences are reflected in the cost (i.e., the premium) of employer-sponsored medical plans.

Age, sex and geographic differentials are determinants of medical plan costs that are not within an employee's control. A tax on employer contributions that does not allow for these differences can discriminate against older employees, females, and employees living in high-cost medical areas. These groups would be affected most directly by a tax on employer medical plan contributions.

Life Insurance

Under current law, imputed employer costs for group term life insurance are tax exempt for coverage that is less than $50,000. Treasury recommends that this tax exclusion be repealed and that all imputed employer costs be included in employee taxable income in the year they are paid.

Treasury cites significant inequities between employees who are covered by employer-sponsored plans and those who must purchase coverage on their own with after-tax dollars. This "inequity" could be corrected by allowing a tax deduction for individuals who must purchase term life insurance with after-tax dollars because their employers do not offer this benefit.

Treasury also suggests that the tax exclusion lowers the after-tax cost of term life insurance coverage and, thereby, encourages employees to ask for additional insurance that they probably would not purchase on their own. This reasoning overlooks the purpose of employer-sponsored group term life insurance and the extent of employee coverage. These plans provide valuable, cost-efficient income security protection for dependents of employees who die during the prime of their working years. This coverage is particularly important for employees with young dependents.

Life insurance coverage for public employees is not considered generous by private sector standards. Typically, an employee receives coverage equal to the individual's salary or a flat dollar amount unrelated to salary level. Of the plans included in our study, flat dollar coverage ranged from a low of $2,500 to a high of $15,000.

Life insurance coverage for white collar employees in the private sector tends to be salary related. In 1982, 96 percent of private sector employees in medium and large organizations were covered by employer-sponsored plans. Aproximately 80 percent of salaried employees have basic life insurance coverage that ranged between one and two times salary. In contrast, 50 percent of full-time production workers participated in flat dollar plans and 80 percent of them had coverage that ranged between $2,000 and $15,000. [15]

The cost of group term life insurance coverage, typically under $0.30 per month for each $1,000 of coverage, is an inexpensive method of providing needed survivor protection to all employees, usually without regard to an employee's age, salary level, or service with an employer. In the state and local government sector, death benefits usually are provided to survivors of deceased employees through the employer's pension plan. However, most public pension plans require employees to have completed five to ten years of service before they are entitled to survivor coverage. Without adequate and relatively inexpensive life insurance protection, many short-service public employees, especially younger public employees with dependent children, are totally unprotected. The fact is that many public and private sector employees have inadequate survivor income protection and are not aware of the financial risk created by gaps in coverage.

---

[15] U.S. Bureau of Labor Statistics, Employee Benefits in Medium and Large Firms, 1983, August 1984, pp. 8-9, 40-42..

Pension Benefits

Scenario #1 of our study considered the effects on public employees of taxing employees on pension and all other employer benefit plan contributions that receive special tax treatment in the year these contributions are made.

Taxing employer pension contributions would create serious inequities because employer contributions bear no relationship to the value of benefits being accrued by an employee. The level of employer pension contributions depends directly on the actuarial cost method being used to fund benefits. There are six advance funding methods approved by ERISA for private sector pension plans. Each method can accumulate by retirement date the necessary reserve to fund benefits for any given employee if the method is applied in all years and if actuarial assumptions are realized. The ultimate cost of each funding method (when adjusted for the time value of money) is the same; only the incidence of cost changes. Thus, a particular funding method will call for larger yearly contributions in a given year than other methods, and these contributions will not necessarily bear any direct relationship to the benefit that an employee earns in that year.

Public pension plans are not required to meet the funding requirements of ERISA, although many public plans do follow the same or similar advance funding standards. However, some public plans finance benefits on a pay-as-you-go basis; an employer's pension contribution for the year is the amount needed to pay for benefits owed that year to retirees and other beneficiaries of the plan. No contributions are made to fund benefits before employees reach retirement age. As the number of retirees grows, employer contributions increase accordingly to meet current year liabilities.

If actual employer pension contributions were taxed, public employees who participate in pay-as-you-go plans would be paying a tax on contributions that meet the cost of benefits currently being paid to retired employees; these contributions would not finance benefits being earned by active employees.

Employees participating in plans that are funded in advance of an employee's retirement would be paying tax on contributions required by the plan's funding method, and these contributions also would not be related directly to the benefits being earned by employees because contribution levels vary considerably from one funding method to another.

Our study did not base estimated tax increases in Scenario #1 on actual employer pension contributions being made by each of the six employers in our sample. Instead, we determined the value of benefits being earned in 1985 and included that amount in employee taxable income. (See Appendix A for a more detailed description of our approach.)

Each employee's accrued benefit depended directly on the pension plan's benefit formula, normal retirement age, employee contributions, and whether benefits were adjusted automatically for inflation.

Career employees, older employees, and higher-paid employees would pay significant taxes on pension accruals; employees with short service, particularly younger employees, would be affected the least.

Other issues arise in taxing pension accruals. For example:

- Would nonvested as well as vested employees be taxed even though nonvested employees would not be entitled to benefits?
- Would employees who have not completed the required years of service to qualify for a pension plan's disability and death benefits be required to pay tax on accruals that are attributed to those benefits?
- Would employees pay tax on employer contributions to pension plans that provide postretirement medical benefits, which usually are financed on a pay-as-you-go basis? (The same issue arises with employer-sponsored medical benefits.)

Other changes in the tax treatment of pension plans also would create fundmental problems. For example, changes in tax rules that currently provide favorable tax treatment of lump-sum pension distributions could restrict an employee's flexibility in planning for retirement, especially if an employee will be receiving benefits from more than one employer. Rules proposed by Treasury, for example, would remove most of the special tax treatment of lump-sum distributions and, thereby, encourage employees to elect an annuity over a lump-sum payments.

Most public employees participate in defined benefit plans. The maximum annual dollar limit that a person can receive from a defined benefit plan is $90,000 for benefits commencing between ages 62 and 65. The maximum benefit is reduced actuarially for pension payments commencing before age 62 and increased actuarially for pension payments commencing after age 65.

It may appear at first that the maximum dollar limit on defined benefits would not be relevant to public pension plans because state and local government employee salaries are not high enough to produce annual benefits above $90,000. However, a closer examination shows that the limit may affect benefits that public employees receive if pension payments begin at a very early age.

Proposals to lower the maximum limit will affect public as well as private sector employees. Retirement in the forties or early fifties is not uncommon for certain groups of public employees, including police officers, fire fighters, and other hazardous duty employees. For some of these career employees and for disabled employees, the maximum dollar limit on pension benefits commencing at these early retirement ages may be less than the amount they otherwise might have been entitled to receive. At age 45, for example, the maximum yearly benefit for a retiree may be $37,000 or less, depending on the actuarial assumptions that are used. If the maximum limit is lowered from $90,000 to $45,000, as proposed by Senator Bill Bradley and Representative Richard Gephardt, an increasing number of public and private sector employees could have their pension benefits reduced significantly.

There are many other possible changes in the tax treatment of employer-sponsored pension plans being considered that are beyond the scope of this report. Major changes in the tax treatment of these plans could have an effect on an employee's capacity to save for retirement. Current tax rules, although imperfect, have been sucessful in stimulating the growth of employer-sponsored plans, employee savings, and economic growth. In evaluating the appropriateness of proposed changes, Congress needs to assess whether these goals will be better met in the future through changes in existing employee benefit tax policy and, if so, how this will occur.

Other Benefits

Proposals for changing tax treatment of employee benefit plans cover many areas beyond basic medical, life insurance, and retirement benefits. For example, Treasury recommends that the current tax exclusion on employer-sponsored educational assistance and group legal service plans not be renewed beyond their December 31, 1985 expiration date.

Section 127 of the Internal Revenue Code excludes from employee taxable income employer contributions of up to $5,000 per year for educational assistance. Between 1978 and 1984, over 7 million employees furthered their education through Section 127.[16]

In 1976 Congress enacted Section 120 of the Tax Code, which authorizes that employer contributions to qualified group legal services be excluded from employee income. In a number of jurisdictions, including the cities of Columbus (Ohio), Philadelphia, and New York, employees are covered by these plans. One of the first to be established was the Municipal Employees Legal Services Plan of AFSCME's District Council 37. Financed by New York City contributions, this plan offers legal services to 100,000 active New York City employees, 15,000 retirees, and their families.[17]

The current tax exclusion of employer contributions for educational assistance, group legal plans, and other employer-sponsored benefits beyond the four basics also needs to be evaluated in terms of the role these plans play in strengthening the economic security of employees and in improving employee morale and productivity.

Possible Employer and Employee Reaction To Tax Changes

In 1984 Mercer-Meidinger surveyed chief executive officers (CEOs) of an array of medium and large private corporations about possible changes in the tax treatment of employee benefit plans. Of the 504 respondents, 46 percent were in charge of companies that employ over 5,000 workers and 14 percent had work forces exceeding 20,000. Virtually all of the firms sponsored medical, life insurance, and retirement plan benefits.

---

[16] Statement of Senator Patrick Moynihan, Congressional Record, February 28, 1985.

[17] March 29, 1984 statement by AFSCME, submitted to Senator Robert Packwood.

The overwhelming conclusion of the survey was that:

> Any material change in tax preferences for employee benefits will significantly alter the role of employers and employees in providing for their own income security and will create pressure on the government to fill any void left by reduced company-sponsored benefit programs.[18]

The survey also showed that:

- o Eighty-seven percent of CEOs who responded believe that current benefit tax policy should remain unchanged.
- o Eighty-nine percent believe that eliminating current tax treatment of employee benefits would have a negative effect on the health and welfare of employees and their families.
- o Eighty-one percent agree that eliminating special tax treatment of employee benefits is not a sensible approach to raising federal revenue.
- o Sixty-nine percent believe that current tax rules have been influential in encouraging their companies to sponsor employee benefit plans.
- o Fifty-seven percent foresee reducing their company-sponsored benefit plans by 1990 if Congress alters the tax treatment of employee benefits.

Major changes in employee benefit policy could generate other negative reactions as well. If employers respond to these changes by reducing benefits

---

18. William M. Mercer-Meidinger, Incorporated, Employer Attitues Toward Employee Benefits and Tax Change, September 1984, p. 1.

significantly, pressure would be exerted by employees and unions for Congress to expand Social Security and perhaps establish other social insurance programs to help restore lost benefits. These changes also could have a divisive effect on employees, pitting one group against another. For example, younger employees might be required to pay a tax on employer medical contributions because older employees have driven up the overall cost of the plan above the flat dollar, tax-exempt limit. Resentment could build among younger employees toward older employees and eventually might affect employee morale and productivity.

Many employees work on a part-time basis and some of these part-timers are among the lowest paid employees in the American work force. Because employer medical plan contributions are not income related, those part-timers who are covered by employer-sponsored medical plans would be affected most severely. This additional tax might encourgage part-timers and other low paid employees to drop out of the work force. We also suspect that employers would be inclined to drop medical coverage for part-timers if their contributions are taxed. This would excerbate an existing public policy problem of providing medical plan coverage to low income employees and the unemployed who are not covered by group medical plans.

There is a certain unfairness in using tax policy to promote the establishment of employer-sponsored benefit plans and then, once these plans are established and cover the majority of American workers, changing tax policy and removing the "carrot." If we assume that current tax policy resulted in the development of employer-sponsored benefit plans that exist today, then it would be unreasonable to assume that a significantly different tax policy would be neutral and not influence employer-employee decisions about benefits, including existing benefits. It is only reasonable to assume that employers, confronted with a new tax policy, would make decisions consistent with that new policy and not the old policy; previous benefit decisions would be reversed and the present employer-sponsored benefit system dismantled to the extent it is inconsistent with new tax policy.

SECTION V

CONCLUSION

Major changes in employee benefit tax policy will have serious effects on the financial security of employees and their families. Our study shows that if employer benefit plan contributions were taxed using current rates:

- public employees in low and moderate salary brackets would pay higher income and Social Security tax under the three scenarios that were examined; the majority of public employees fall within these salary brackets.
- in some cases, employees would pay increased taxes from existing income for benefits that they might receive sometime in the future.
- two-earner couples, who are a growing presence in the American work force, in particular, would be affected severely.
- a tax on employer medical contributions would worsen existing inequities between employees in different family situations.

If employer contributions also are taxed for Social Security purposes, employers as well as covered employees would pay additional Social Security tax on employer contributions that fall within Social Security's taxable wage base ($39,600 in 1985).

Taxation of employer benefit plan contributions will create other problems as well. For example, a tax on employer medical plan contributions:

- would lead to adverse selection in some plans and eventual reductions in medical benefits.

- o would discriminate against employees located in high-cost medical areas, and certain individual employees or groups with high concentrations of older employees and females.

Such changes would weaken the financial security of employees and their families and eventually could disrupt employee-employer relations.

Employer-sponsored benefits plan represent a private approach to income security protection for employees and their families. In its absence, these benefits probably would have been provided through an expanded Social Security system and other social insurance programs.

Employer-sponsored plans have achieved many social and economic objectives that have been made possible through special tax rules enacted by Congress over the last four decades. As a result, for example, employer-sponsored plans:

- o have been instrumental in improving the health status of employees and their families.
- o have promoted individual savings through pension plans and other permitted employer-sponsored arrangements.
- o have been a key factor in assuring continued economic growth in this country.
- o have reduced the need for federal social insurance programs, which would be supported by higher taxes.

In evaluating the appropriateness of current employee benefit tax policy and proposed changes thereto, Congress needs to make its policy decisions in terms of the goals and accomplishments of employer-sponsored plans and the role that the Tax Code has played in helping employer-sponsored plans achieve their objectives.

APPENDICES

APPENDIX A

PRINCIPAL ASSUMPTIONS USED IN DEVELOPING COMPUTER MODEL

1. Employees are age 45 and will have completed 15 years of service by the end of 1985.

2. Employee annual salaries in 1985 are $15,000, $20,000, and $25,000.

3. 1985 individual federal income tax rates were used.

4. Taxable income was determined as follows:

Single employees:	one exemption of $1,000, plus deductions equal to the greater of the $2,300 standard deduction for single employees or 16 percent of gross salary.
Married employees:	two exemptions of $1,000 per person (a total of 4 exemptions if married couple has two dependent children), plus the greater of the $3,400 standard deduction for a married couple filing jointly or 20 percent of gross salary.

5. Marginal tax rates corresponded with taxable income of employees at salary brackets of $15,000, $20,000, and $25,000. In the case of a two-earner couple, the marginal tax rate corresponded with the couple's combined income.

6. To determine the increase in federal income tax, marginal tax rates were multiplied by the additional taxable income attributable to employer benefit plan contributions under each of the three scenarios.

7. To determine the increase in Social Security tax, additional covered earnings were equal to the increase in taxable income for employees who participate in Social Security, provided total covered earnings did not exceed Social Security's taxable wage base of $39,600 in 1985. The increase

in covered earnings was then multiplied by 7.05 percent, the 1985 Social Security payroll tax rate.

8. The increase in taxable income attributable to taxing employer pension "contributions" was based on the estimated increase in present value of an employee's accrued pension benefit during 1985. The defined benefit pension formulas of the surveyed plans were used to determine accrued pension benefits through 1984 and then through 1985. Annual salaries in 1985 were assumed to be 5 percent higher than 1984 salaries. Accrued benefits were reduced by employee contributions to obtain the employer-paid accrued benefit. The difference between the 1985 and 1984 employer-paid benefit was multiplied by PBGC (Pension Benefit Guaranty Corporation) annuity factors at the plan's normal retirement age, using a factor based on a 9 percent immediate interest rate, to obtain the increase in present value of accrued benefits for 1985. If the pension plan also contained an automatic cost-of-living adjustment (COLA), the increase in present value was adjusted to reflect the present value of the COLA. These calculations did not consider the value of disability, survivor, and other non-retirement benefits that the surveyed plans might provide.

9. The taxable amount of employer group term life insurance "contributions" was determined in the same manner as imputed group term life insurance costs are determined today for employer-paid coverage that exceeds $50,000. The Internal Revenue Code Section 79 Rate Table, which imputes employer costs for each $1,000 of coverage on an age-related basis, was used to calculate additional taxable income attributable to the cost of employer-paid term life insurance.

10. Factors derived from published rate sources were used to unbundle health benefits for jurisdictions that do not have premiums set on a double-rate (individual and family) or triple-rate (individual, married employee and spouse with no dependent children, and family) basis.

APPENDIX C

REPRESENTATIVE JOB TITLES AND APPROXIMATE ANNUAL SALARIES OF EMPLOYEES WHO HAVE COMPLETED 15 YEARS OF SERVICE WITH SURVEYED EMPLOYERS

	Annual Salary		
Public Employer	$15,000	$20,000	$25,000
University of California	Cook	Respiratory Therapist II	Accountant
	Groundskeeper	Truck Driver	Automotive Mechanic
	Key Entry Operator	Psychiatric Technician	Auditor
	Laborer		Lab Technician
	Library Assistant II		Lead Physical Plant Operator
	Secretary II		
	Security Guard		
Cook County	Stenographer II	Accountant II	Caseworker III
	Custodial Worker II	Stenographer V	Programmer
	Telephone Operator II	Practical Nurse II	Youth Service Worker II
	Data Entry Operator II	Correctional Officer I	Investigator II
	Security Officer		Probation Officer II
	Warehouse Worker		
	Building Service Worker		

Public Employer	Annual Salary		
	$15,000	$20,000	$25,000
Milwaukee County	Laundry Operator	Gardner II	Accountant III
	Clerk Typist II	Correction Officer II	Equipment Operator II
	Food Service Worker II	HV Mechanic II	Programmer I
	Library Aide	Drafting Technician	Power Plant Operator
	Keypunch Operator	Caseworker	Chemist
		Trades Helper	Registered Nurse
		Sewage Plant Operator	
State of Michigan	Word Processor	Laborer II	Accountant
	Psychiatric Aide	Licensed Practical Nurse	Architect
	Nurses Aide	Dietician	Machinist
	Food Service Worker	Power Plan Operator	Automotive Mechanic VI
	Stenographer	Drafter	Gardner
	Data Entry Operator	Correction Officer	Butcher II
		Groundskeeper	
Nassau County	Receptionist	Accountant V	Correction Officer
	Clerk Typist II	Caseworker I	Physical Therapist
	Laborer I	Librarian	Greenskeeper III
	Stenographer	Equipment Operator III	Registered Nurse II
	Custodial Worker II	Storekeeper III	Dietician II
	Equipment Operator I	Maintenance Lead Plumber	Mechanic II
	Data Entry Operator		Social Worker

Public Employer	Annual Salary		
	$15,000	$20,000	$25,000
Prince Georges County	Painter	Work Processing Operator II	Accountant I
	Clerk Typist I	Correction Officer I	Auditor I
	Engineering Aide	Administrative Aide I	Systems Analyst
	Equipment Operator I	Administrative Aide II	
	Trades Helper	Dispatcher II	
	Account Clerk I	Sr. Electrician	

Source: AFSCME

APPENDIX D

DETAILED RESULTS OF COMPUTER MODEL UNDER THREE SCENARIOS FOR TAXING EMPLOYER BENEFIT PLAN CONTRIBUTIONS *

---

* On the tables following, the column titled medical and dental also includes employer contributions for vision care and prescription drug benefits, where these benefits are available.

APPENDIX B

APSCME SURVEY OF EMPLOYEE BENEFIT PLANS SPONSORED BY SIX PUBLIC EMPLOYERS

	Surveyed Employers		
Employee Benefit[1]	**University of California**	**Cook County**	**Milwaukee County**
Health Benefits [2] (Monthly Employer Contributions)			
Medical	$136.00 (I); $366.00 (F)	$140.60 (I); $268.20 (F)	$107.47 (I); $268.05 (F)
Dental	$ 14.42 (I); $ 40.18 (F)	--	$ 7.04(I); $ 25.00 (F)
Vision	--	--	--
Prescription Drug	--	--	--
Social Security Coverage	Yes	No	Yes
Term Life Insurance	$5,000	$2,500	$15,000
Pension Benefits			
Normal Retirement	Age 70	Age 60 with 20 years	Age 60 or age 55 with 30 years of service
Benefit Formula	2.3% X final average salary (FAS) X service up to 4/1/76 + 2.2% X FAS X service after 4/1/76 minus 2% x primary Social Security benefit x service	1.67 % X FAS X 1st 10 years +1.9 % X FAS X 2nd 10 years +2.1 % X FAS X 3rd 10 years +2.3 % X FAS X years over 30	2% X FAS X service
Automatic COLA	Up to 2% per year	Up to 2% per year	Up to 2% per year
Employee Contributions	2% of salary up to Social Security taxable wage base; 4% above taxable wage base minus $19 per month	8.5 % of salary	None

Employee Benefit	Surveyed Employers		
	State of Michigan	Nassau County	Prince Georges County
Employer Contributions for Health Benefits (monthly)			
Medical	$100.13 (I); $214.21 (M) $280.51 (F)	$92.88 (I); $197.57 (F)	$72.97 (I); $198.69 (F)
Dental	$ 14.71(I); $26.76 (M) $ 44.76(F)	$16.90 (C)	$8.35 (I); $15.81 (F)
Vision	$ 2.48(I); $4.35 (M); $ 7.17(F)	--	$ 2.92(I); $10.24 (F)
Prescription Drug			
Social Security Coverage	Yes	Yes	Yes
Term Life Insurance	2 times annual salary	None (optional coverage available)	2 times annual salary
Pension Benefits			
Normal Retirement	Age 60 with 10 years of service; Age 55 with 30 years	Age 60	Age 62 with 5 years, 63 with 4, 64 with 3, 65 with 2, or 30 years regardless of age.
Benefit Formula	1.5% X FAS X Service	2% X FAS X Service	0.8 % of salary to covered compensation base; 1.6 % above base
Automatic COLA	No	No	Up to 3% per year
Employee Contributions	None	No	None up to Social Security taxable wage base

---

1. This survey was not intended to be a comprehensive treatment of benefit plans sponsored by these six employers. It was designed only to collect information on these plans that was relevant to making our calculations.

2. (I) indicates monthly employer contributions for single employees with no dependent children; (F) for married employees with dependent children (except for the State of Michigan where there is a separate rate for married employees with and without dependent children, in which case (M) denotes the rate for married employee without dependent children). (C) indicates that there is a composite rate for employees.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE A1

EMPLOYER : COOK COUNTY, ILLINOIS

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	SINGLE
SALARY	$15,000
WORKING SPOUSE	N/A
MARGINAL TAX RATE	18%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$29	$29	$5	$0	$0	$0	$0
2.LIFE INS	N/A	9	2	9	2	9	2
3.MEDICAL & DENTAL	1,687	1,687	304	1,687	304	847	152
SUBTOTAL	$1,716	$1,725	$310	$1,696	$306	$856	$154
ADDIT'L SS (iv)	N/A	$0	$0	$0	$0	$0	$0
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$310	N/A	$306	N/A	$154

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE A2

EMPLOYER : COOK COUNTY, ILLINOIS

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	SINGLE
SALARY	$20,000
WORKING SPOUSE	N/A
MARGINAL TAX RATE	23%

		SCENARIO 01 TAX ALL EMPLOYER CONTRIBS FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO 02 TAX ALL EMPLOYER CONTRIBS FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO 03 TAX EMPLOYER CONTRIBS ABOVE MEDICAL CAP AND EMPLOYER CONTRIBS FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	258	258	59	00	00	00	00
2.LIFE INS	N/A	9	2	9	2	9	2
3.MEDICAL & DENTAL	1,467	1,467	338	1,467	338	847	195
SUBTOTAL	$1,725	$1,734	$399	$1,476	$340	$856	$197
ADDIT'L SS (iv)	N/A	00	00	00	00	00	00
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$399	N/A	$340	N/A	$197

(i) IN SCENARIO 03, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS 01,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #3

EMPLOYER : COOK COUNTY, ILLINOIS

EMPLOYEE : AGE	45
YEARS OF SERVICE	15
MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
SALARY	$30,000
WORKING SPOUSE	$15,000
MARGINAL TAX RATE	25%

(1)	(2)	SCENARIO #1 TAX ALL EMPLOYER CONTRIBS FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIBS FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIBS ABOVE MEDICAL CAP AND EMPLOYER CONTRIBS FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
		(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIBS (ii)	TAXABLE AMT OF ER BEN CONTRIBS	INCREASE IN FEDERAL TAX ON ER BEN CONTRIBS	TAXABLE AMT OF ER BEN CONTRIBS	INCREASE IN FEDERAL TAX ON ER BEN CONTRIBS	TAXABLE AMT OF ER BEN CONTRIBS	INCREASE IN FEDERAL TAX ON ER BEN CONTRIBS
1.PENSIONS (iii)	$38	$38	$10	$0	$0	$0	$0
2.LIFE INS	N/A	9	2	9	2	9	2
3.MEDICAL & DENTAL	3,218	3,218	805	3,218	805	1,118	280
SUBTOTAL	$3,256	$3,265	$816	$3,227	$807	$1,127	$282
ADDIT'L SS (iv)	N/A	$0	$0	$0	$0	$0	$0
ADDIT'L FE INCOME AND SS TAX	N/A	N/A	$816	N/A	$807	N/A	$282

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #4

EMPLOYER : COOK COUNTY, ILLINOIS

EMPLOYEE : AGE 45

YEARS OF SERVICE	13
MARITAL STATUS	MARRIED W/ 2 DEPENDENT CHILDREN
SALARY	$20,000
WORKING SPOUSE	$15,000
MARGINAL TAX RATE	22%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$38	$38	$8	$0	$0	$0	$0
2.LIFE INS	N/A	9	2	9	2	9	2
3.MEDICAL & DENTAL	3,218	3,218	708	3,218	708	1,118	246
SUBTOTAL	$3,256	$3,265	$718	$3,227	$710	$1,127	$248
ADDIT'L SS (iv)	N/A	$0	$0	$0	$0	$0	$0
ADDIT'L SS INCOME AND SS TAX	N/A	N/A	$718	N/A	$710	N/A	$248

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE A5

EMPLOYER : COOK COUNTY, ILLINOIS

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	SINGLE
	SALARY	$25,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	26%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$48	$48	$12	$0	$0	$0	$0
2.LIFE INS	N/A	9	2	9	2	9	2
3.MEDICAL & DENTAL	1,687	1,687	439	1,687	439	847	220
SUBTOTAL	$1,735	$1,744	$453	$1,696	$441	$856	$223
ADDIT'L SS (iv)	N/A	$0	$0	$0	$0	$0	$0
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$453	N/A	$441	N/A	$223

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE A6

EMPLOYER : COOK COUNTY, ILLINOIS

EMPLOYEE : AGE 45

YEARS OF SERVICE 15
MARITAL STATUS MARRIED W/ 0 DEPENDENT CHILDREN
SALARY $25,000
WORKING SPOUSE N/A
MARGINAL TAX RATE 18%

		SCENARIO 01 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO 02 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO 03 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$48	$48	$9	$0	$0	$0	$0
2.LIFE INS	N/A	9	2	9	2	9	2
3.MEDICAL & DENTAL	3,218	3,218	579	3,218	579	1,118	201
SUBTOTAL	$3,266	$3,275	$589	$3,227	$581	$1,127	$203
ADDIT'L SS (iv)	N/A	$0	$0	$0	$0	$0	$0
ADDIT'L SS INCOME AND SS TAX	N/A	N/A	$589	N/A	$581	N/A	$203

(i) IN SCENARIO 03, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS 01,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE A7

EMPLOYER : COOK COUNTY, ILLINOIS

EMPLOYEE : AGE 45

YEARS OF SERVICE 15
MARITAL STATUS MARRIED W/ 0 DEPENDENT CHILDREN
SALARY $25,000
WORKING SPOUSE $20,000
MARGINAL TAX RATE 28%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$48	$48	$13	$0	$0	$0	$0
2.LIFE INS	N/A	9	2	9	2	9	2
3.MEDICAL & DENTAL	3,218	3,218	901	3,218	901	1,118	313
SUBTOTAL	$3,266	$3,275	$917	$3,227	$904	$1,127	$316
ADDIT'L SS (iv)	N/A	$0	$0	$0	$0	$0	$0
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$917	N/A	$904	N/A	$316

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #1

EMPLOYER : NASSAU COUNTY, NEW YORK

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	SINGLE
SALARY	$15,000
WORKING SPOUSE	N/A
MARGINAL TAX RATE	18%

		SCENARIO #1		SCENARIO #2		SCENARIO #3	
		TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$2,007	$2,007	$361	$0	$0	$0	$0
2.LIFE INS	N/A	0	0	0	0	0	0
3.MEDICAL & DENTAL	1,212	1,212	218	1,212	218	372	67
SUBTOTAL	$3,219	$3,219	$579	$1,212	$218	$372	$67
ADDIT'L SS (iv)	N/A	$3,219	$227	$1,212	$85	$372	$26
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$806	N/A	$304	N/A	$93

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE TO THE [illegible]

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 [illegible]

EFFECT OF POSSIBLE CHANGES IN THE TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE 32

EMPLOYER : NASSAU COUNTY,NEW YORK

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	SINGLE
SALARY	$20,000
WORKING SPOUSE	N/A
MARGINAL TAX RATE	23%

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$2,676	$2,676	$615	$0	$0	$0	$0
2.LIFE INS	N/A	0	0	0	0	0	0
3.MEDICAL & DENTAL	1,212	1,212	279	1,212	279	372	86
SUBTOTAL	$3,888	$3,888	$894	$1,212	$279	$372	$86
ADDIT'L SS (iv)	N/A	$3,888	$274	$1,212	$85	$372	$26
ADDIT'L SS INCOME AND SS TAX	N/A	N/A	$1,168	N/A	$364	N/A	$112

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #3

EMPLOYER : NASSAU COUNTY,NEW YORK

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
SALARY	$20,000
WORKING SPOUSE	$15,000
MARGINAL TAX RATE	25%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$2,676	$2,676	$669	$0	$0	$0	0
2.LIFE INS	N/A	0	0	0	0	0	0
3.MEDICAL & DENTAL	2,638	2,638	659	2,638	659	538	134
SUBTOTAL	$5,314	$5,314	$1,328	$2,638	$659	$538	$134
ADDIT'L SS (iv)	N/A	$5,314	$375	$2,638	$186	$538	$38
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,703	N/A	$845	N/A	$172

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #4

EMPLOYER : NASSAU COUNTY,NEW YORK

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	MARRIED W/ 2 DEPENDENT CHILDREN
SALARY	$20,000
WORKING SPOUSE	$15,000
MARGINAL TAX RATE	22%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$2,676	$2,676	$589	$0	$0	$0	0
2.LIFE INS	N/A	0	0	0	0	0	0
3.MEDICAL & DENTAL	2,630	2,630	580	2,630	580	530	118
SUBTOTAL	$5,306	$5,306	$1,169	$2,630	$580	$530	$118
ADDIT'L SS (iv)	N/A	$5,306	$375	$2,630	$186	$530	$38
ADDIT'L FE INCOME AND SS TAX	N/A	N/A	$1,544	N/A	$766	N/A	$156

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE 85

EMPLOYER : NASSAU COUNTY,NEW YORK

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	SINGLE
SALARY	$25,000
WORKING SPOUSE	N/A
MARGINAL TAX RATE	26%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$3,345	$3,345	$870	$0	$0	$0	0
2.LIFE INS	N/A	0	0	0	0	0	0
3.MEDICAL & DENTAL	1,212	1,212	315	1,212	315	372	97
SUBTOTAL	$4,557	$4,557	$1,185	$1,212	$315	$372	$97
ADDIT'L SS (iv)	N/A	$4,557	$321	$1,212	$85	$372	$26
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,506	N/A	$401	N/A	$123

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED ENLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE 36

EMPLOYER : NASSAU COUNTY,NEW YORK

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
SALARY	$75,000
WORKING SPOUSE	N/A
MARGINAL TAX RATE	18%

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$3,345	$3,345	$602	$0	$0	$0	0
2.LIFE INS	N/A	0	0	0	0	0	0
3.MEDICAL & DENTAL	2,638	2,638	475	2,638	475	530	97
SUBTOTAL	$5,983	$5,983	$1,077	$2,638	$475	$530	$97
ADDIT'L SS (iv)	N/A	$5,983	$422	$2,638	$186	$530	$38
ADDIT'L SS INCOME AND SS TAX	N/A	N/A	$1,499	N/A	$661	N/A	$135

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #7

EMPLOYER : NASSAU COUNTY,NEW YORK

EMPLOYEE : AGE 46

YEARS OF SERVICE	15
MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
SALARY	$25,000
WORKING SPOUSE	$30,000
MARGINAL TAX RATE	28%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSIONS (iii)	$3,345	$3,345	$937	$0	$0	$0	0
2.LIFE INS	N/A	0	0	0	0	0	0
3.MEDICAL & DENTAL	2,638	2,638	739	2,638	739	538	151
SUBTOTAL	$5,983	$5,983	$1,675	$2,638	$739	$538	$151
ADDIT'L SS (iv)	N/A	$5,983	$422	$2,638	$186	$538	$38
ADDIT'L SS INCOME AND SS TAX	N/A	N/A	$2,097	N/A	$925	N/A	$189

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE C1

EMPLOYER : STATE OF MICHIGAN

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	SINGLE
	SALARY	$15,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	18%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$930	$930	$167	$0	$0	$0	$0
2.LIFE INS	N/A	104	19	104	19	104	19
3.MEDICAL & DENTAL	1,408	1,408	253	1,408	253	568	102
SUBTOTAL	$2,338	$2,442	$439	$1,512	$272	$672	$121
ADDIT'L SS (iv)	N/A	$2,442	$172	$1,512	$107	$672	$47
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$612	N/A	$379	N/A	$168

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED ENLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE C2

EMPLOYER : STATE OF MICHIGAN

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	SINGLE
	SALARY	$20,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	23%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$1,240	$1,240	$285	$0	$0	$0	0
2.LIFE INS	N/A	139	32	139	32	139	32
3.MEDICAL & DENTAL	1,408	1,408	324	1,408	324	568	131
SUBTOTAL	$2,648	$2,787	$641	$1,547	$356	$707	$163
ADDIT'L SS (iv)	N/A	$2,787	$196	$1,547	$109	$707	$50
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$837	N/A	$465	N/A	$212

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE C3

EMPLOYER : STATE OF MICHIGAN

EMPLOYEE : AGE 45

YEARS OF SERVICE 15
MARITAL STATUS MARRIED W/ 0 DEPENDENT CHILDREN
SALARY $20,000
WORKING SPOUSE $15,000
MARGINAL TAX RATE 25%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$1,240	$1,240	$310	$0	$0	$0	0
2.LIFE INS	N/A	139	35	139	35	139	35
3.MEDICAL & DENTAL	2,944	2,944	736	2,944	736	844	211
SUBTOTAL	$4,184	$4,323	$1,081	$3,083	$771	$983	$246
ADDIT'L SS (iv)	N/A	$4,323	$305	$3,083	$217	$983	$69
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,386	N/A	$988	N/A	$315

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE C4

EMPLOYER : STATE OF MICHIGAN

EMPLOYEE : AGE 45

YEARS OF SERVICE 15
MARITAL STATUS MARRIED W/ 2 DEPENDENT CHILDREN
SALARY $20,000
WORKING SPOUSE $15,000
MARGINAL TAX RATE 22%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$1,240	$1,240	$273	$0	$0	$0	0
2.LIFE INS	N/A	139	31	139	31	139	31
3.MEDICAL & DENTAL	3,989	3,989	878	3,989	878	1,889	416
SUBTOTAL	$5,229	$5,368	$1,181	$4,128	$908	$2,028	$446
ADDIT'L SS (iv)	N/A	$5,368	$378	$4,128	$291	$2,028	$143
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,559	N/A	$1,199	N/A	$589

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE C5

EMPLOYER : STATE OF MICHIGAN

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	SINGLE
	SALARY	$25,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	26%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$1,350	$1,350	$403	$0	$0	$0	$0
2.LIFE INS	N/A	174	45	174	45	174	45
3.MEDICAL & DENTAL	1,608	1,608	366	1,108	366	568	148
SUBTOTAL	$2,958	$3,132	$814	$1,282	$411	$742	$193
ADDIT'L SS (iv)	N/A	$3,132	$221	$1,322	$112	$742	$52
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,035	N/A	$523	N/A	$245

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS
ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE 6A

EMPLOYER : STATE OF MICHIGAN

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
SALARY	$25,000
WORKING SPOUSE	N/A
MARGINAL TAX RATE	18%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT OF ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT OF ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT OF ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$1,550	$1,550	$279	$0	$0	$0	0
2.LIFE INS	N/A	174	31	174	31	174	31
3.MEDICAL & DENTAL	2,944	2,944	530	2,944	530	844	152
SUBTOTAL	$4,494	$4,668	$840	$3,118	$561	$1,018	$183
ADDIT'L SS (iv)	N/A	$4,668	$329	$3,118	$220	$1,018	$72
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,169	N/A	$781	N/A	$255

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE C7

EMPLOYER : STATE OF MICHIGAN

EMPLOYEE : AGE 45

YEARS OF SERVICE 15
MARITAL STATUS MARRIED W/ 0 DEPENDENT CHILDREN
SALARY $25,000
WORKING SPOUSE $20,000
MARGINAL TAX RATE 28%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$1,550	$1,550	$434	$0	$0	$0	0
2.LIFE INS	N/A	174	49	174	49	174	49
3.MEDICAL & DENTAL	2,944	2,944	824	2,944	824	844	236
SUBTOTAL	$4,494	$4,668	$1,307	$3,118	$873	$1,018	$285
ADDIT'L SS (iv)	N/A	$4,668	$329	$3,118	$220	$1,018	$72
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,636	N/A	$1,093	N/A	$357

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #1

EMPLOYER : COUNTY OF MILWAUKEE, WISCONSIN

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	SINGLE
	SALARY	$15,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	18%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSIONS (iii)	$1,421	$1,421	$256	$0	$0	$0	$0
2.LIFE INS	N/A	52	9	52	9	52	9
3.MEDICAL & DENTAL	1,374	1,374	247	1,374	247	534	96
SUBTOTAL	$2,796	$2,848	$513	$1,426	$257	$586	$106
ADDIT'L SS (iv)	N/A	$2,848	$201	$1,426	$101	$586	$41
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$713	N/A	$357	N/A	$147

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #2

EMPLOYER : COUNTY OF MILWAUKEE, WISCONSIN

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	SINGLE
	SALARY	$20,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	23%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$1,895	$1,895	$436	$0	$0	$0	$0
2.LIFE INS	N/A	52	12	52	12	52	12
3.MEDICAL & DENTAL	1,374	1,374	316	1,374	316	534	123
SUBTOTAL	$3,269	$3,322	$764	$1,426	$328	$586	$135
ADDIT'L SS (iv)	N/A	$3,322	$234	$1,426	$101	$586	$41
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$998	N/A	$429	N/A	$176

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS

ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #3

EMPLOYER : COUNTY OF MILWAUKEE, WISCONSIN

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
	SALARY	$20,000
	WORKING SPOUSE	$15,000
	MARGINAL TAX RATE	25%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$1,895	$1,895	$474	$0	$0	$0	$0
2.LIFE INS	N/A	52	13	52	13	52	13
3.MEDICAL & DENTAL	3,517	3,517	879	3,517	879	1,417	354
SUBTOTAL	$5,412	$5,464	$1,366	$3,569	$892	$1,469	$367
ADDIT'L SS (iv)	N/A	$5,464	$385	$3,569	$252	$1,469	$104
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,751	N/A	$1,144	N/A	$471

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE 84

EMPLOYER : COUNTY OF MILWAUKEE, WISCONSIN

EMPLOYEE : AGE 45

YEARS OF SERVICE 15
MARITAL STATUS MARRIED W/ 2 DEPENDENT CHILDREN
SALARY $20,000
WORKING SPOUSE $15,000
MARGINAL TAX RATE 22%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$1,895	$1,895	$417	$0	$0	$0	$0
2.LIFE INS	N/A	52	11	52	11	52	11
3.MEDICAL & DENTAL	3,517	3,517	774	3,517	774	1,417	312
SUBTOTAL	$5,412	$5,464	$1,202	$3,569	$785	$1,469	$323
ADDIT'L SS (iv)	N/A	$5,464	$385	$3,569	$252	$1,469	$104
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,587	N/A	$1,037	N/A	$427

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #5

EMPLOYER : COUNTY OF MILWAUKEE, WISCONSIN

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	SINGLE
SALARY	$25,000
WORKING SPOUSE	N/A
MARGINAL TAX RATE	26%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$2,369	$2,369	$616	$0	$0	$0	$0
2.LIFE INS	N/A	52	14	52	14	52	14
3.MEDICAL & DENTAL	1,374	1,374	357	1,374	357	334	139
SUBTOTAL	$3,743	$3,795	$987	$1,426	$371	$386	$152
ADDIT'L SS (iv)	N/A	$3,795	$268	$1,426	$101	$386	$41
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,254	N/A	$472	N/A	$194

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE 86

EMPLOYER : COUNTY OF MILWAUKEE, WISCONSIN

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
	SALARY	$25,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	16%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$2,369	$2,369	$379	$0	$0	$0	$0
2.LIFE INS	N/A	52	8	52	8	52	8
3.MEDICAL & DENTAL	3,517	3,517	563	3,517	563	1,417	227
SUBTOTAL	$5,886	$5,938	$950	$3,569	$571	$1,469	$235
ADDIT'L SS (iv)	N/A	$5,938	$419	$3,569	$252	$1,469	$104
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,369	N/A	$823	N/A	$339

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $74 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #7

EMPLOYER : COUNTY OF MILWAUKEE, WISCONSIN

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
SALARY	$25,000
WORKING SPOUSE	$20,000
MARGINAL TAX RATE	28%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$2,369	$2,369	$663	$0	$0	$0	$0
2.LIFE INS	N/A	52	15	52	15	52	15
3.MEDICAL & DENTAL	3,517	3,517	985	3,517	985	1,417	397
SUBTOTAL	$5,886	$5,938	$1,663	$3,569	$999	$1,469	$411
ADDIT'L SS (iv)	N/A	$5,938	$419	$3,569	$252	$1,469	$104
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$2,081	N/A	$1,251	N/A	$515

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE II

EMPLOYER : PRINCE GEORGES COUNTY, MARYLAND

EMPLOYEE :	AGE	43
	YEARS OF SERVICE	13
	MARITAL STATUS	SINGLE
	SALARY	$13,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	18%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$46	$46	$8	$0	$0	$0	$0
2.LIFE INS	N/A	104	19	104	19	104	19
3.MEDICAL & DENTAL	1,011	1,011	182	1,011	182	171	31
SUBTOTAL	$1,057	$1,161	$209	$1,115	$201	$275	$50
ADDIT'L SS (iv)	N/A	$1,161	$82	$1,115	$79	$275	$19
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$291	N/A	$279	N/A	$69

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE E2

EMPLOYER : PRINCE GEORGES COUNTY, MARYLAND

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	SINGLE
SALARY	$20,000
WORKING SPOUSE	N/A
MARGINAL TAX RATE	23%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$255	$255	$59	$0	$0	$0	$0
2.LIFE INS	N/A	139	32	139	32	139	32
3.MEDICAL & DENTAL	1,011	1,011	233	1,011	233	171	39
SUBTOTAL	$1,266	$1,405	$323	$1,150	$265	$310	$71
ADDIT'L SS (iv)	N/A	$1,405	$99	$1,150	$81	$310	$22
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$422	N/A	$346	N/A	$93

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE E3

EMPLOYER : PRINCE GEORGES COUNTY, MARYLAND

EMPLOYEE : AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
SALARY	$20,000
WORKING SPOUSE	$15,000
MARGINAL TAX RATE	25%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$255	$255	$64	$0	$0	$0	0
2.LIFE INS	N/A	139	35	139	35	139	35
3.MEDICAL & DENTAL	2,697	2,697	674	2,697	674	597	149
SUBTOTAL	$2,952	$3,091	$773	$2,836	$709	$736	$184
ADDIT'L SS (iv)	N/A	$3,091	$218	$2,836	$200	$736	$52
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$991	N/A	$909	N/A	$236

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE E4

EMPLOYER : PRINCE GEORGES COUNTY, MARYLAND

EMPLOYEE : AGE 45

YEARS OF SERVICE 15
MARITAL STATUS MARRIED W/ 2 DEPENDENT CHILDREN
SALARY $20,000
WORKING SPOUSE $15,000
MARGINAL TAX RATE 22%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$255	$255	$56	$0	$0	$0	0
2.LIFE INS	N/A	139	31	139	31	139	31
3.MEDICAL & DENTAL	2,697	2,697	593	2,697	593	597	131
SUBTOTAL	$2,952	$3,091	$680	$2,836	$624	$736	$162
ADDIT'L SS (iv)	N/A	$3,091	$218	$2,836	$200	$736	$52
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$898	N/A	$824	N/A	$214

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED ENLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE 15

EMPLOYER : PRINCE GEORGES COUNTY, MARYLAND

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	SINGLE
	SALARY	$25,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	26%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT OF ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT OF ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT OF ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$463	$463	$120	$0	$0	$0	$0
2.LIFE INS	N/A	174	45	174	45	174	45
3.MEDICAL & DENTAL	1,011	1,011	263	1,011	263	171	44
SUBTOTAL	$1,474	$1,648	$429	$1,185	$308	$345	$90
ADDIT'L SS (iv)	N/A	$1,648	$116	$1,185	$84	$345	$24
ADDIT'L FE INCOME AND SS TAX	N/A	N/A	$545	N/A	$392	N/A	$114

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE E6

EMPLOYER : PRINCE GEORGES COUNTY, MARYLAND

EMPLOYEE : AGE 65

YEARS OF SERVICE	15
MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
SALARY	$25,000
WORKING SPOUSE	N/A
MARGINAL TAX RATE	18%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$463	$463	$83	$0	$0	$0	0
2.LIFE INS	N/A	174	31	174	31	174	31
3.MEDICAL & DENTAL	2,697	2,697	485	2,697	485	597	107
SUBTOTAL	$3,160	$3,334	$600	$2,871	$517	$771	$139
ADDIT'L SS (iv)	N/A	$3,334	$235	$2,871	$202	$771	$54
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$835	N/A	$719	N/A	$193

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE E7

EMPLOYER : PRINCE GEORGES COUNTY, MARYLAND

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
	SALARY	$25,000
	WORKING SPOUSE	$20,000
	MARGINAL TAX RATE	28%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSIONS (iii)	$463	$463	$130	$0	$0	$0	0
2.LIFE INS	N/A	174	49	174	49	174	49
3.MEDICAL & DENTAL	2,697	2,697	755	2,697	755	597	167
SUBTOTAL	$3,160	$3,334	$934	$2,871	$804	$771	$216
ADDIT'L SS (iv)	N/A	$3,334	$235	$2,871	$202	$771	$54
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,169	N/A	$1,006	N/A	$270

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE F1

EMPLOYER : UNIVERSITY OF CALIFORNIA

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	SINGLE
	SALARY	$15,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	18%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$123	$123	$22	$0	$0	$0	$0
2.LIFE INS	N/A	17	3	17	3	17	3
3.MEDICAL & DENTAL	1,805	1,805	325	1,805	325	965	174
SUBTOTAL	$1,928	$1,945	$350	$1,822	$328	$982	$177
ADDIT'L SS (iv)	N/A	$1,945	$137	$1,822	$128	$982	$69
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$487	N/A	$457	N/A	$246

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE F2

EMPLOYER : UNIVERSITY OF CALIFORNIA

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	SINGLE
	SALARY	$20,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	23%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$141	$141	$33	$0	$0	$0	$0
2.LIFE INS	N/A	17	4	17	4	17	4
3.MEDICAL & DENTAL	1,805	1,805	415	1,805	415	965	222
SUBTOTAL	$1,946	$1,964	$452	$1,822	$419	$982	$226
ADDIT'L SS (iv)	N/A	$1,964	$138	$1,822	$128	$982	$69
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$590	N/A	$548	N/A	$295

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #1

EMPLOYER : UNIVERSITY OF CALIFORNIA

EMPLOYEE ; AGE 45

YEARS OF SERVICE	15
MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
SALARY	$20,000
WORKING SPOUSE	$15,000
MARGINAL TAX RATE	23%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$141	$141	$35	$0	$0	$0	$0
2.LIFE INS	N/A	17	4	17	4	17	4
3.MEDICAL & DENTAL	4,875	4,875	1219	4,875	1219	2,775	694
SUBTOTAL	$5,016	$5,033	$1,258	$4,892	$1,223	$2,792	$698
ADDIT'L SS (iv)	N/A	$5,033	$355	$4,892	$345	$2,792	$197
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,613	N/A	$1,568	N/A	$895

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS
ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE F4

EMPLOYER : UNIVERSITY OF CALIFORNIA

EMPLOYEE : AGE 45

YEARS OF SERVICE 15
MARITAL STATUS MARRIED w/ 2 DEPENDENT CHILDREN
SALARY $20,000
WORKING SPOUSE $15,000
MARGINAL TAX RATE 22%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
EMPLOYEE BENEFIT	1985 ER BEN PLAN CONTRIB (ii)	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	TAXABLE AMT ON ER BEN CONTRIB	INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$141	$141	$31	$0	$0	$0	$0
2.LIFE INS	N/A	17	4	17	4	17	4
3.MEDICAL & DENTAL	4,874	4,874	1072	4,874	1072	2,774	610
SUBTOTAL	$5,016	$5,033	$1,107	$4,892	$1,076	$2,792	$614
ADDIT'L SS (iv)	N/A	$5,033	$355	$4,892	$345	$2,792	$197
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,462	N/A	$1,421	N/A	$811

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3, SINCE NO ADDITIONAL [illegible]

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE #5

EMPLOYER : UNIVERSITY OF CALIFORNIA

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	SINGLE
	SALARY	$25,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	26%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$230	$230	$60	$0	$0	$0	$0
2.LIFE INS	N/A	17	5	17	5	17	5
3.MEDICAL & DENTAL	1,805	1,806	469	1,805	469	965	251
SUBTOTAL	$2,035	$2,053	$534	$1,822	$474	$982	$255
ADDIT'L SS (iv)	N/A	$2,053	$145	$1,822	$128	$982	$69
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$679	N/A	$602	N/A	$325

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMPLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE F6

EMPLOYER : UNIVERSITY OF CALIFORNIA

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	MARRIED W/ 0 DEPENDENT CHILDREN
	SALARY	$25,000
	WORKING SPOUSE	N/A
	MARGINAL TAX RATE	18%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS,AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$230	$230	$41	$0	$0	$0	$0
2.LIFE INS	N/A	17	3	17	3	17	3
3.MEDICAL & DENTAL	4,874	4,874	877	4,874	877	2,774	499
SUBTOTAL	$5,105	$5,122	$922	$4,892	$880	$2,792	$502
ADDIT'L SS (iv)	N/A	$5,122	$361	$4,892	$345	$2,792	$197
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,283	N/A	$1,225	N/A	$699

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

STATEMENT
# of the
AMERICAN MEDICAL ASSOCIATION
to the
Subcommittee on Labor-Management Relations
Committee on Education and Labor
U.S. House of Representatives

RE: ERISA Oversight

April 12, 1985

The American Medical Association takes this opportunity to submit its comments on the subject of the Employee Retirement Income Security Act (ERISA). In this statement, we will primarily discuss the impact of ERISA insofar as it currently preempts state regulation of certain health benefit plans, leaving beneficiaries without proper protection. This statement contains the amendments recommended to provide such protection and we urge their adoption.

INTRODUCTION

The primary concern of the American Medical Association with the current ERISA law relates to a legal/legislative technicality that exists in the administration of ERISA with respect to employers who develop self-funded trusts to fund health care benefit plans for their employees. Specifically, we are concerned about the ERISA preemption of appropriate state regulation concerning certain employee health benefit plans.

SELF-FUNDED BENEFIT PLANS

As the cost of health care has risen in recent years, many employers have sought to reduce their expenditures for employee health benefits. One method that is becoming increasingly prevalent is for business to self-fund employee health plans. Self-funding is a program for providing group coverage with benefits financed entirely through the internal resources of the employer, in place of purchasing insurance from commercial carriers or Blue Cross/Blue Shield.

Self-funding is a rapidly growing phenomenon. According to surveys conducted by the International Foundation of Employee Benefit Plans, the percentage of employer-sponsored health plans that are fully self-funded has grown from 30% in 1979 to 50.6% in 1983. The number of fully insured plans (where underwriting risk is assumed by the carrier) has declined from 45% in 1979 to only 21.5% in 1983. In each year, the remainder of plans were partially insured (e.g., minimum premium payment plans).

The American Medical Association supports a pluralistic approach to health care financing and delivery and recognizes employer self-funded health insurance plans as one among many means of providing health benefits to employees. We do believe, however, that when businesses self-fund, employee-participants should enjoy the basic legal protections of employees covered by group health insurance plans and that such self-funded trusts should have certain basic obligations under state law as do other health insurance plans.

ERISA AND SELF-FUNDED PLANS--A REGULATORY GAP

The Employee Retirement Income Security Act of 1974 (ERISA) supersedes or preempts all state laws relating to employee benefit plans except for insurance, banking and securities regulation laws. The law also states that employee benefit plans operated by an employer cannot be deemed to be insurance, banking or securities business in order to come under state regulation. Unlike employer cash pension plans, which are closely regulated by the federal government, controls have not been established at the federal level specifically concerning employer provided health benefit plans. This arrangement has led to problems, with self-funded health benefit plans escaping appropriate regulation due to the broad preempting language of federal law and an absence of federal regulation.

Three years ago this regulatory gap first became a major public policy problem with the widely publicized failures throughout the country of a number of self-funded "multiple-employer trusts", or "METs", leaving in their wake thousands of beneficiaries with unpaid medical and hospital bills.

Congress responded to this problem by including language in Public Law 97-473, enacted January 14, 1983, which allows state regulation of "Multiple Employer Welfare Arrangements." P.L. 97-473 exempts from the ERISA preemption any state laws that require multiple employer welfare arrangements (METs) to maintain specified levels of reserves and contributions.

The AMA supported the enactment of P.L. 97-473. However, we believe that insurance regulatory problems continue to exist which warrant further limiting of ERISA preemption of state laws.

NEED FOR AMENDING ERISA

The American Medical Association believes that with the fast-growing proportion of workers receiving health benefit coverage through self-funded mechanisms it becomes more and more important that states be given the authority to subject such plans to specific portions of appropriate state insurance laws. Several important reasons exist for treating self-funded plans in similar fashion as other group health insurance:

- protection of individual beneficiaries through imposition of state solvency standards,
- strengthening the effectiveness of state risk pooling mechanisms,
- assurance of delivery of quality health care, and
- assuring access to participation in plans by health care providers.

The regulation of the business of insurance has been primarily a responsibility of state legislatures over the years. ERISA is a notable exception to this area of state-oriented public policy. The American Medical Association has always supported and continues to support a regulatory environment for health insurance focused at the state level. We believe that each state should determine its own response to the varying needs for protection of its citizens.

Protection of Individuals. Provisions of state insurance codes requiring specified levels of capitalization and reserves were enacted in order to provide policyholders and beneficiaries with fundamental assurances that their insurance would be available when they needed it. This system has worked quite well with each state establishing standards designed to meet its needs and conditions. The growing number of persons covered by health plans that are not governed by these consumer protection laws, however, undermines the public benefit served by such state legislative safeguards. The American Medical Association believes that all workers should be entitled to the same safeguards under state insurance laws and that such safeguards should not be dependent upon whether the beneficiaries are enrolled in a regulated group insurance plan or an unregulated self-funded plan.

State Risk Pooling for Health Insurance. Reliable estimates indicate that nearly one million persons are unable to obtain insurance in the private market because of medical problems. While this number is small in proportion to the general population, in our view, it represents a significant social problem.

Seven states have legislation creating or authorizing a risk-sharing or reinsurance association to offer health insurance at a reasonable cost to persons who are high-risk or "uninsurable" by conventional underwriting standards. While some of these laws provide that self-insurers are to participate in the risk-sharing association, the states are effectively precluded by ERISA from enforcing such a requirement. We believe that the problem of providing coverage for medically uninsurable persons is of sufficient dimension to merit enactment of state legislation requiring special efforts for coverage of this group in every state.

In our view all health care financing entities in a state should be required to participate in such pooling arrangements. Such programs providing coverage for this group benefit all citizens within a state. Such programs can be financially viable only if participation by all health care financing entities, including commercial insurers, non-profit medical or hospital service plans, HMOs and self-funded groups, is required.

Only with such uniform participation can adverse selection be avoided and a financial base sufficient to support the program be assured. Participation of self-funded groups in such a state program cannot be required at present because of the preemption in ERISA against any state-level regulation of self-funded groups. This should be changed.

Quality of Care Concerns. Some states are beginning to develop health plan regulations to help assure the delivery of high quality care in health plans. For example, California law provides, among other things, that contracts with group policy holders "shall include programs for the continuous review of the quality of care, performance of medical personnel, utilization of services and facilities and costs, by professionally recognized unrelated third parties." These requirements are not applicable to self-funded entities due to the ERISA "regulatory gap." We believe that ERISA should be amended to provide that any state law provisions designed to provide quality of care assurances should be applicable to self-funded health plans in that state.

Accessibility of Providers. Present state laws regulating insurance plans as to accessibility of providers vary significantly. Many states have laws designed to assure freedom of choice of provider and payment for services rendered by such providers. However, these laws are not applicable to self-funded plans due to the ERISA exemption. Based on an analysis we have conducted of relevant statutes, it would appear quite possible that, in many if not most states, applicable state legislation generally would not prohibit nonprofit service plans from marketing contracts which would refuse payment entirely for services rendered by non-participating providers. While commercial insurance companies are on the whole still subject to relatively stringent state prohibitions against any contractual restriction in the subscribers' freedom of choice, there appears to be relatively little statutory impediment to nonprofit medical service plans making no payment to either patient or physician for services provided by non-participating physicians.

AMA DRAFT FEDERAL LEGISLATION

The AMA has developed draft federal legislation to amend ERISA so that states may exercise certain regulatory authority over self-funded plans. The draft bill would create additional exemptions to the general rule of ERISA preemption of state laws. The new exceptions would provide that state insurance laws could apply in the case of an employee welfare benefit plan (i.e., a self-funded employer's plan) established for the purpose of providing medical, surgical, or hospital care or benefits, to the extent that the state law provides for standards requiring the maintenance of specified levels of reserves and contributions, participation in health insurance risk pools, requirements for the quality of health care provided through such a plan, requirements to assure access to participation by health care providers, and provisions to enforce such standards. A copy of our draft legislation is attached to this statement.

CONCLUSION

The American Medical Association urges the Subcommittee to adopt our draft bill to amend ERISA to permit the states to exercise appropriate regulation of a growing segment of the group health benefit market.

1824p

January, 1985

ERISA AMENDMENT RE: STATE REGULATION OF SELF INSUREDS

This bill would create exceptions to the general rule in ERISA (the Employees Retirement Income Security Act of 1974) which provides that ERISA supersedes all state laws relating to employee benefit plans except for insurance, banking and securities regulation laws. The law also states that employee benefit plans operated by an employer cannot be deemed to be insurance, banking or securities businesses. The exceptions created in the draft bill would provide that a self-insured employer's plan would be subject to state insurance laws in the case of an employee welfare benefit plan established for the purpose of providing medical, surgical, or hospital care or benefits, to the extent that the law provides for standards requiring the maintenance of specified levels of reserves and contributions, participation in health insurance risk pools, regulation of accessibility of providers and quality of care, and provisions to enforce such standards.

The need for this legislation arises from the problems created by the ERISA pre-emption of state laws, specifically, the lack of appropriate governmental regulation at either the state or federal level of solvency requirements and other fundamental public interest safeguards routinely required of other entities providing health insurance protection.

- American Medical Association -

Department of Federal Legislation, Division of Legislative Activities

99th Congress
1st Session

Draft

Bill No. ____

IN THE (SENATE)(HOUSE) OF THE UNITED STATES

Date __________

________ of _______ introduced the following bill;
which was read twice and referred
to the _______________ Committee

A BILL

To amend the Employee Retirement Income Security Act of 1974 to define the extent to which State laws are preempted by such Act with respect to employee welfare benefit plans which provide health care benefits.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 514 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1144) is amended by deleting the period at the end of subparagraph (b)(2)(B) and inserting in lieu thereof the following:

", except that in the case of an employee welfare benefit plan established for the purpose of providing medical, surgical, hospital care or benefits, or any trust established under such a plan, any law of any State which regulates insurance may apply to such plan to the extent that such law provides—

(i) standards, requiring the maintenance of specified levels of reserves and specified levels of contributions which any such plan, or any trust established under such a plan, must meet in order to be considered under such law able to pay benefits in full when due,

(ii) requirements to participate in health insurance risk pools,

(iii) requirements for the quality of health care provided through such a plan,

(iv) requirements to assure access to participation by health care providers, and

(v) provisions to enforce such standards and requirements."

EFFECT OF POSSIBLE CHANGES IN TAX TREATMENT OF EMPLOYER BENEFIT PLAN CONTRIBUTIONS ON STATE AND LOCAL GOVERNMENT EMPLOYEES

EXAMPLE F7

EMPLOYER : UNIVERSITY OF CALIFORNIA

EMPLOYEE :	AGE	45
	YEARS OF SERVICE	15
	MARITAL STATUS	MARRIED w/ 0 DEPENDENT CHILDREN
	SALARY	$25,000
	WORKING SPOUSE	$20,000
	MARGINAL TAX RATE	28%

		SCENARIO #1 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS AT 1985 MARGINAL RATES		SCENARIO #2 TAX ALL EMPLOYER CONTRIB FOR CURRENTLY TAX-FAVORED BENEFITS, EXCEPT PENSIONS, AT 1985 MARGINAL RATES		SCENARIO #3 TAX EMPLOYER CONTRIB ABOVE MEDICAL CAP AND EMPLOYER CONTRIB FOR LIFE INSURANCE, REGARDLESS OF COVERAGE, AT 1985 MARGINAL RATES (i)	
(1) EMPLOYEE BENEFIT	(2) 1985 ER BEN PLAN CONTRIB (ii)	(3) TAXABLE AMT ON ER BEN CONTRIB	(4) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(5) TAXABLE AMT ON ER BEN CONTRIB	(6) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB	(7) TAXABLE AMT ON ER BEN CONTRIB	(8) INCREASE IN FEDERAL TAX ON ER BEN CONTRIB
1.PENSION (iii)	$230	$230	$65	$0	$0	$0	$0
2.LIFE INS	N/A	17	5	17	5	17	5
3.MEDICAL & DENTAL	4,874	4,874	1365	4,874	1365	2,774	777
SUBTOTAL	$5,105	$5,122	$1,434	$4,892	$1,370	$2,792	$782
ADDIT'L SS (iv)	N/A	$5,122	$361	$4,892	$345	$2,792	$197
ADDIT'L EE INCOME AND SS TAX	N/A	N/A	$1,795	N/A	$1,714	N/A	$978

(i) IN SCENARIO #3, MEDICAL CAP WAS SET AT $70 PER MONTH FOR SINGLE EMPLOYEES AND $175 PER MONTH FOR MARRIED EMLOYEES.

(ii) EMPLOYER CONTRIBUTIONS FOR PENSIONS, LIFE INSURANCE COVERAGE UNDER $50,000, AND MEDICAL/DENTAL CONTRIBUTIONS CURRENTLY ARE NOT TAXABLE IN THE YEAR THEY ARE MADE.

(iii) THIS FIGURE REPRESENTS THE ESTIMATED INCREASE IN ACCRUED PRESENT VALUE OF EMPLOYER-PROVIDED PENSION BENEFITS DURING 1985.

(iv) ADDITIONAL SS REFERS TO ADDITIONAL SOCIAL SECURITY COVERED EARNINGS AND SOCIAL SECURITY TAX RESULTING FROM SCENARIOS #1,2 AND 3. WHERE NO ADDITIONAL COVERED EARNINGS AND TAX ARE INDICATED, EMPLOYEE IS NOT COVERED BY SOCIAL SECURITY.

Statement to the Subcommittee on Labor/Management Relations of the House Committee on Education and Labor By Anchor National Life Insurance Company

Anchor National Life Insurance Company is a life insurance company, organized under the laws of the state of California and admitted to do the business of insurance in the District of Columbia and all states except New York. Anchor National Life has some $5 billion of life insurance and $1.45 billion of annuities in-force with approximately 17,554 insurance agents appointed and licensed to sell life insurance policies and annuity contracts. At the end of 1984, Anchor National Life had 123,645 deferred annuity contracts in-force.

Anchor National Life is a member of the Committee of Annuity Insurers and supports fully and without reservation the statement of that group which will be filed with the Subcommittee. This statement is submitted as a supplement to the group's statement in an effort to provide the Subcommittee with information relative to this Company's business which, due to time constraints, could not be provided on behalf of the entire group.

Anchor National Life welcomes the efforts of this Subcommittee to open a public debate on a national retirement income policy since it is in this context, rather than as a revision of the entire income tax structure that the merits of the private sector's participation in the retirement planning area is most usefully debated.

We firmly believe that the three existing elements of the current system, social security, employer sponsored pensions, and individual initiative, represented by tax qualfied IRA's and nonqualified commercial annuities each has its place in an appropriate policy formulation. Social security which is valuable as a floor, or safety net, to prevent destitution during the retired years, should be looked upon as a minimum level government subsistence program. That it is the mimimum level and not a complete source of retirement benefits should be clearly communicated to the public together with the message that people can and must utilize the other non-public elements of the system to maintain their present living standards.

While the social security system relies on an immediate transfer of revenues, the private system is largely prefunded so that the ultimate retirement benefits paid out represent less of an immediate drain on the economy. This tax deferred prefunding mechanism provides valuable capital accumulation sources to the national economy during the prefunding years and should serve, if adequate governmental encouragement is provided, to lessen the ultimate pressures on social security for ever increasing levels of benefits. Indeed, one of the most important goals of any national retirement income policy must be to foster and encourage increasing levels of private initiative.

Currently before the Congress is the Treasury proposal to reform the tax system. The stated goals, to afford more equity and to simplify the tax system, are laudable in themselves since an equitable and simple system are undeniably desirable. However, as part of the purposal the Treasury would change the tax treatment historically afforded to deferred annuity contracts. Anchor National Life opposes the Treasury proposal to tax, in each year, the year by year increase in the cash value of nonqualified, individual deferred annuities. Further, we would emphasize that the adoption of the Treasury proposal as it relates to nonqualified deferred annuities would have the effect, for reasons stated below, of eliminating these products from the marketplace. This result would be extremely detrimental to any effort to change the present drift toward increasing dependence on social security. The nonqualified deferred annuity serves a valuable and meritorius purpose and deserves the continued encouragement afforded by present tax laws. The reasons for change in the present law, which are offered in support of the Treasury proposal, are neither substantial nor compelling.

Under the present law, the interest portion of the annuity value is taxed as payments are being made to the annuitant. In other words, taxation of the interest is deferred, not done away with, while accumulating in the annuity. This treatment of the interest accumulation in annuity value has been accorded to such contracts since the inception of our income tax law in 1913. The formulae for taxing annuity payments has changed periodically, but the bedrock of tax policy respecting deferred annuities has remained throughout--no taxation while the value is accumulating in the annuity. This is as it should be--to encourage thrift and planning for a financially adequate and independent retirement income, with taxation corresponding to the availability of funds and spread over the period that income payments are being made.

The essence of the contractual obligations of the life insurance company have not changed since the inception of this business early in the 20th Century. Life insurance protects against the risk of early death; annuity contracts protect against the risk of outliving one's life expectancy and thereby exhausting one's means of support in retirement. Under a deferred annuity contract, the insurer undertakes to guarantee to the purchaser:

1. The premiums for the purchase of the deferred annuity.
2. A modest rate of interest to be applied to the premium over the life of the contract from the purchase date to the retirement date. In Anchor National Life's current flexible premium deferred annuities, this rate is 4% per annum.
3. In the case of most insurers today, additional interest in excess of 4% is guaranteed annually. This is due to

the generally higher yields currently available in the money market, greater efficiencies in the conduct of the life insurance business and a willingness on the part of these insurers to accrue to their deferred annuity contractholders a greater portion of the interest earnings on their premiums. Anchor National Life's products currently range in first year guaranteed interest rates from 9.00% to 10.76%.

5. Periodic income for the life of the annuitant commencing on the retirement date (usually age 65 or 70). In this the insurer assumes the risk that the annuitant may outlive his or her life expectancy and is obligated to provide the periodic income in an amount fixed at retirement for however long the annuitant lives. Often a period certain is specified to protect against the early death of the annuitant by the selection of a beneficiary to receive the balance of the period certain payments.

The corollary to the insurer's promises are the benefits and advantages accruing to the persons who purchase deferred annuities. These advantages are:

1. Security of their premiums as represented by the annuity cash value.

2. Increase in the annuity cash value through the accumulation of interest earned by the insurer and credited to the annuity.

3. An annuity value at retirement which has kept pace with inflation through a competitive interest accumulation and tax deferral.

4. Retirement income for the lifetime of the annuitant. The increasing importance of this unique feature of annuities cannot be over emphasized. Life expectancy is increasing and with it both the need and the concern for financial independence in retirement.

Not only are the reasons for retaining the present law compelling and historically sound, as they have been found by prior sessions of Congress, most recently in 1978, 1982 and 1984, but also an analysis of the alleged abuses of deferred annuities contained in the Treasury Report to Congress shows them to be less than persuasive in support of the proposal. It is submitted that the annuity product has been closely examined and that the unduly favorable elements of the program have already been treated in the 1982 and 1984 tax legislation. The products in their present form and under current tax law are truely advantageous only as retirement vehicles. A brief examination of the tax changes made to date is in order.

Under the Tax Equity and Fiscal Responsibility Act (TEFRA), passed in 1982, great changes were made in the taxation of deferred annuities with the effect of ensuring that they could not be used as short term vehicles in substitution for bank deposits and C.D.'s and that they would be used only as long term retirement vehicles. TEFRA changed the law by reversing the ordering rules relating to withdrawals from an annuity and requiring that such withdrawals be treated first as taxable income to the extent of accumulated interest and then as tax free return of premium payments. Policy loans were efectively disallowed by treating them as taxable withdrawals. Additionally, a penalty tax of 5% was assessed against taxable interest income withdrawn prior to 59-1/2, or 10 years from the date of the contract, whichever was earlier. Premature withdrawals, or loans would result in early and tax disadvantaged recognition of income, as would premature surrender of the policy.

In the Tax Reform Act of 1984 Congress further restricted the ability to make withdrawals by imposing a penalty tax on withdrawals at any time prior to age 59-1/2 regardless of the holding period of the policy. Additionally, definitional language was added to the Internal Revenue Code which requires policies to force distribution of policy values on the transfer of the policy by reason of the death of the owner to anyone other than a surviving spouse. The Technical Corrections Act to the 1984 Tax Reform Act, now pending as H.R. 1800, would expand the forced distribution rules to include transfers by gift as well as by reason of death. With these modifications, as provided in the 1982 and 1984 Acts, Congress granted its approval to the concept of tax deferral for nonqualified annuities.

The Treasury explanation of its annuity proposal is significant both for what it does say and what it does not say. The Treasury explanation does not attempt to analyze the value of deferred annuity programs as a needed element of total retirement income. Indeed Chapter 12.07 of the Treasury report mentions the word retirement in the context of nonqualified annuities only once. That mention is in the context of a complaint that deferred annuity savings are more likely to be withdrawn than other retirement savings because the penalty tax on premature withrawals is lower. We note in reply that most deferred annuities have charges for early withdrawal during all or part of the deferred period in varying percentages. Anchor National's withdrawal charges range from 6% for 7 years to 10% declining over a 10 year period. The net effect of the combination of a withdrawal charge and the tax penalty is at many durations greater than the 10% penalty for IRA's. We would further note that an IRA and a nonqualified deferred annuity are not equivalent since the funds placed in an IRA generate a tax deduction from current income not available to deferred annuities.

The Treasury's principal arguments seem to be 1) that the tax advantages afforded deferred annuities, by now reduced exclusively to the tax deferral of internal buildup, have somehow resulted in a major distortion in savings flows out of other financial institutions and into the life insurance industry and 2) that the use of tax deferred annuities should be eliminated because somehow the tax deferral favors wealthier individuals. We would like to address these concerns.

The argument that savings flows were seriously distorted due to the tax deferral of the internal interest buildup was examined and rejected by Congress in the proceedings on the Revenue Act of 1978. The argument itself is an attempt to compare apples and oranges. Bank deposits and C.D.'s are essentially different than deferred annuities both in nature and in ultimate purpose. Bank deposits and C.D.'s provide short term liquidity and a degree of flexibility not present in annuities under existing tax laws. Finally, even if one were to accept this argument, it does not necessarily follow that the deferred annuity is bad and should be eliminated.

The second Treasury argument, that tax deferral of annuities favors wealthy individuals, was also considered by Congress in 1978 and at that time was not considered a sufficient reason to eliminate the tax deferred treatment. The experience of Anchor National demonstrates that the primary appeal of the deferred annuity is to the middle class. This is demonstrated by the Company's average current policy cash value of approximately $11,800 (considered on the basis of accumulated premiums plus interest). The average premium received is of course much smaller. Additionally, it should be noted that the current range of minimum premiums which will be accepted by the

Company for an annuity is between $240.00 (payable at $20.00 per month) and $1,500.00. Thus, a purchaser of relatively modest means is able to afford an annuity. It is precisely this group which it is most critical from a policy standpoint to encourage into long term retirement savings. And it is this group that, if forced by the adoption of the Treasury proposal to pay a tax on funds which they will not withdraw for many years, would be most inclined to drop their annuity programs. And finally, the wealthy, who are also capable of affording greater risks, can achieve much better rates of return together with tax benefits from the purchase of tax shelter programs. The argument for the great attractiveness of the deferred annuity to the highest income classes of society is just not persuasive.

In conclusion, we believe that the deferred annuity policy, with deferral of taxation on the interest accumulation until such time as a benefit payment results, is a valid and necessary component of any national retirement income policy. It is demonstrable that this product is being purchased largely by persons of middle income and modest means and largely at later ages* for the primary purpose of providing an additional income source for their retirement. The long standing Congressional policy of deferring taxation of the interest accumulation on deferred annuities encourages individual thrift and retirement planning. The social and economic benefits supporting this present tax policy are increasingly compelling due to the present inability of the social security system to keep pace with inflation and demographically driven demands upon it. We welcome the interest and concern of the Committee and would be willing to supply additional information as needed.

---

*Although the Company has not compiled statistics on age of purchaser, the consensus is that the purchasers tend to be older persons who are considering retirement in the near future.

STATEMENT
OF THE
BLUE CROSS AND BLUE SHIELD ASSOCIATION

ON

EMPLOYER-PROVIDED FRINGE BENEFITS

SUBMITTED TO THE
EDUCATION AND LABOR SUBCOMMITTEE
ON LABOR - MANAGEMENT RELATIONS

April 3, 1985

encourages individual thrift and retirement planning. The social and economic benefits supporting this present tax policy are increasingly compelling due to the present inability of the social security system to keep pace with inflation and demographically driven demands upon it. We welcome the interest and concern of the Committee and would be willing to supply additional information as needed.

STATEMENT
OF THE
BLUE CROSS AND BLUE SHIELD ASSOCIATION

ON

EMPLOYER-PROVIDED FRINGE BENEFITS

SUBMITTED TO THE
EDUCATION AND LABOR SUBCOMMITTEE
ON LABOR - MANAGEMENT RELATIONS

April 3, 1985

The Blue Cross and Blue Shield Association, the national coordinating organization for all the Blue Cross and Blue Shield Plans, appreciates the opportunity to submit this statement. Today, Blue Cross and Blue Shield Plans provide health care coverage for more than 80 million Americans. Most of our subscribers maintain this coverage through group policies offered by their employers, although a substantial number — 13 million — are covered under individual health benefits contracts. The Blue Cross and Blue Shield Plans also employ over 95,000 workers, who have the opportunity to participate in retirement, and others employee benefit programs.

The Committee has posed a number of questions concerning the availability and scope of fringe benefits. Based on our experience, we would like to comment on those that relate to the treatment of employer-provided health and retirement benefits and the effect of changes in their legal status.

Current labor-management and tax policies clearly establish incentives for employers to provide certain employee benefits — particularly those that protect workers and their families against loss of income or high expenses due to retirement, disability, illness, and death. There are two major principles underlying these policies. The first is that assuring the economic security of active, disabled, and retired workers and their dependents is beneficial to society as a whole, and that a sound national retirement policy is inextricably related to an appropriate employee benefits policy. The second is that government-operated programs alone cannot and should not be expected to achieve the goal of economic security for this population.

We believe these principles are as valid now as they were decades ago when the basic federal policies toward employee benefits were codified. In our view, the fundamental issue is not whether government should be involved in protecting workers and their families from loss of income or the high costs of illness but how the government should be involved. Government involvement can be through incentives in the labor relations and tax laws for the private sector to establish and operate benefit programs, or through the expansion of benefit programs operated directly by the government. We believe that the encouragement of private sector benefit programs is the better alternative. Therefore, we recommend that the current incentives for certain employee benefits be preserved. However, we also recommend that the Employee Retirement Income Security Act (ERISA) be modified to remedy certain problems that have arisen since the passage of the original statute.

Tax Treatment of Health Benefits

Current tax policy encourages the provision of health benefits through employment by not treating the costs an employer incurs to provide these benefits as taxable income to the employee. In addition, the employer does not pay payroll taxes — such as FICA and unemployment — on these costs. These tax policies have been a major factor in the growth of employment-related health coverage. Three quarters of the labor force have employment-related health coverage. This coverage provides protection for about 177 million employees and their dependents.

We believe that this country's extensive group health benefit coverage has had substantial value for workers, employers, health care providers, the government, and society as a whole. Workers, including those who could not afford to buy insurance, or who would otherwise fail to purchase it on their own, are protected from the unexpected and major costs of illness. Health benefits administered and financed through a group of employees are less expensive than if comparable insurance were purchased by individual workers. Moreover, the employer can serve a valuable role in the health insurance marketplace as a well-informed bargaining agent for his or her employees. Through this bargaining and negotiation, employers can tailor a unique health benefits program that meets the often diverse needs of workers and their families as well as the needs of retirees and their dependents. In addition, employers are able to attract and retain workers through the provision of health coverage and the inclusion of particular benefits. Finally, employee morale and productivity are enhanced as a result of increased job satisfaction, and this, in turn, strengthens our economy.

By encouraging private group health benefits, current tax policy also has positive effects on our health care delivery system. Providers of health care services, particularly hospitals, are assured of payment for their services. Because of this, insurers play a major role in avoidance of hospital bad debts, and that means a significantly smaller role for the federal and local governments in support of community hospitals.

Finally, and importantly, existing tax policy reduces the need for expanded government funded and administered entitlement programs.

Because group health coverage is a benefit which is critical to our nation's well-being and productivity, the present tax treatment of health benefits is particularly appropriate. Accordingly, the Blue Cross and Blue Shield Association strongly opposes the taxation of employer-provided health benefits.

We would now like to address briefly proposals to limit the current tax exclusion that applies to employer contributions to health benefits plans.

Proposals for a Tax Cap on Employee Health Benefits

The present Administration and some Members of Congress favor taxing the value of employer-provided health benefits above certain levels — the so-called "tax cap." While, to some, a tax cap may seem to represent a convenient shortcut in dealing with the federal deficit or an effective way to control health care costs, in our opinion the adverse consequences for millions of Americans would be serious.

We believe that the adoption of this type of proposal would be bad labor relations policy, bad tax policy, and bad health policy for the following reasons.

- A tax cap would impose a "sick tax" on older and chronically ill workers, and on their employers. Different employee groups have different health care needs. Because older and chronically ill workers tend to use more health benefits, the cost of providing health benefits to a group in which these workers are heavily represented will be higher than the cost of health benefits for a group of young healthy workers. Consequently, if a cap were imposed on the amount of employer-provided benefits, or for that matter if all of the health benefits were taxed, employees of companies with a relatively high percentage of such workers would have to pay more taxes than workers of other companies. Blue Cross and Blue Shield Association actuarial simulations suggest how the Administration's proposal might affect older workers. The additional taxable income for family coverage provided by a particular Blue Cross and Blue Shield Plan (with a 75 percent employer contribution) is estimated to be 31 times higher for workers employed in older employee groups (average age 55-64) than in younger groups (average age 35-44). Under the Treasury Department's proposal, this would mean taxable income of $1,306 versus $41. Thus, we believe many older workers would have substantially less savings for retirement if they had to pay taxes on their health benefits.

A tax cap could also have other serious, although more indirect, adverse effects on older and chronically ill workers. If employers responded to the tax cap by offering employees a choice of plans — a low option which is non-taxable and a high option which is taxable, those who perceive themselves as healthier likely would choose the lower-cost, minimal coverage plan. Less healthy workers would want the protection of a more comprehensive, higher-cost plan. Over time, the cost of providing services to the high users would drive up the premium of that group and consequently the healthier workers would drop out. This "adverse selection" would put the cost of the more comprehensive protection out of reach for those who need it most.

- A cap would diminish the government's commitment to use tax incentives to have the private market provide protection against health care costs. A major objective of our tax system is to encourage the private sector to undertake socially useful activities in order to minimize the need for tax-supported government programs. A tax cap on health benefits would send a signal that government had reduced its commitment to protecting the health of the work force and their families. Enactment of even a high level tax cap would be deceptive. Once in place, the temptation to "ratchet down" the cap each year — in search of new revenues — would prove irresistible.

- A cap is not needed to contain health care costs. Cost containment has recently emerged as the major factor in the delivery and financing of health care. Purchasers of health care, as well as providers have increased their level of sophistication in a very short time. Programs have been developed to reduce inpatient lengths of stay, to determine whether services such as diagnostic tests and surgery should be performed on an outpatient rather than on an inpatient basis, and to determine prior to hospitalization whether a hospital admission is warranted. For example, by using hospital utilization review, Blue Cross of Iowa reduced small group premiums by a total of $24 million, and Blue Cross of Northeast Ohio reduced experience-rated group premiums by 4 to 6 percent.

Another approach being used to control costs is the offering to employees of financial incentives to use designated hospitals and physicians in the community that, through a contract, will provide health care services for a lower price or with more stringent utilization controls. These new arrangements are called Preferred Provider Organizations — PPOs — and have demonstrated significant savings. For example, by using preferred providers arrangements, Blue Cross of California has cut premiums for large group accounts by an average of 13 percent, while Blue Cross and Blue Shield of Minnesota reduced rates by an average of 10 percent, saving $10 million. A variant on the PPO approach is called "selective contracting," in which an insurer or employer contracts with selected providers in the community whom they know provide high quality services at lower costs. Employees are not reimbursed for their medical expenses if they go to providers not covered under the contract. This also has resulted in lower health care costs for employers.

In addition, more and more employers also are offering their employees the option of a health maintenance organization — an HMO — since HMOs have strong financial incentives to control utilization of services while still providing high quality of care.

These approaches are helping to contain the cost of group health benefits. The Business Roundtable's Task Force on Health recently reported that, as a result of various steps taken by its members, average health care spending per recipient for the first quarter of 1984 increased only 8.4 percent from the first quarter of 1983 compared with 12.7 percent for the same period a year earlier.

- A cap would be regressive taxation. Data from the Congressional Budget Office and the Employee Benefit Research Institute show that, of those employees who would be subject to additional taxes, the financial burden would fall heaviest on those with the lowest incomes. For example, under the Administration's proposed cap, workers who earn less than $10,000 a year would pay an additional 2.8 percent of their income on average. Workers earning more than $50,000 a year would pay taxes equivalent to only 0.4 percent of their income. Reducing the benefit package to a value below the cap could result in dropping important benefits or providing for significantly greater employee cost-sharing. Furthermore, because lower-income persons are less able to pay, any new cost-sharing requirements or out-of-pocket costs for non-covered benefits also would affect them disproportionately.

For all of these reasons, we believe that Congress should not tax employment-related health benefits. Some might charge that the current tax status of employer-provided health benefits is inequitable because it applies only to health coverage obtained through employment. While it is true that health insurance premiums for those who must purchase individual coverage are paid for with after-tax dollars, the medical expense deduction has helped mitigate this expense. If Congress wishes to address the differences in tax treatment of employer-provided versus non-group health coverage, we suggest reconsideration of the 1982 change which raised the threshold for claiming the medical expense deduction from three percent to five percent of adjusted gross income, and eliminated the separate deduction for health insurance premiums up to $150. Restoring the separate premium allowance, in particular, would represent at least a partial solution to this problem.

The ERISA Preemption Problem

ERISA, the Employee Retirement Income Security Act of 1974, represented the culmination of more than ten years of effort at the federal level to enact a comprehensive and uniform statutory framework to protect pension plan participants. The need for federal action was generally agreed to, even by business and labor interests, as the best means to deal with the conflict among and inadequacy of existing state and federal laws. However, while the primary focus of investigation and discussion was pensions, the legislation was drafted to include also "employee welfare benefit plans."

Perhaps the most important aspect of ERISA's application to welfare benefit plans, and in particular to employee health benefits, is its broad preemption of state laws. With the apparent intent of providing for uniformity of regulation, Section 514 of ERISA states that:

> (a) Except as provided in subsection (b) of this section, the provisions of this title and title IV shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 4(a) and not exempt under section 4(b). This section shall take effect on January 1, 1974.

[(b)](2)(A) Except as provided in subparagraph (B), nothing in this title shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.

(B) Neither an employee benefit plan described in section 4(a), which is not exempt under section 4(b) (other than a plan established primarily for the purpose of providing death benefits), nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.

There have been numerous lawsuits involving these three provisions of section 514. The courts have interpreted the intent of the language very literally. Plans which are self-funded, that is, which finance benefits by paying claims directly out of the assets of the company or union trust fund rather than through the purchase of group insurance coverage, may not be treated by the state as insurers or as if they were doing the business of insurance. These uninsured benefit plans are exempt from state regulation, while employers who choose to insure for their employee benefits must comply with all the various state insurance requirements, such as mandated benefit laws.

"Mandated benefit law" is the generic term applied to state statutes requiring that certain benefits be included in insurance policies. These laws differ from traditional state insurance regulation in that they apply to matters of product design and content rather than to matters of business operation and financial solvency or to standards for entry into and conduct in the insurance marketplace.

Prior to ERISA, there were only 48 benefits mandated under the statutes of the fifty states. In the ten years since ERISA's enactment, the number of state mandated benefit laws has grown to 584. It is mandated benefits which are creating much of the current confusion and imbalance in the employee benefits marketplace.

In 1974, only a few large employers or unions were self-funding their benefit plans. However, following the passage of ERISA, smaller businesses began to seek ways to control the content of their own benefit packages through self-funding. This resulted in a proliferation of multiple-employer trusts (METs). METs allow numerous employers to unite and pool their resources and their risks to create a single entity to fund and administer the employee benefits. The critical element for the viability of these programs is the number of employees. If the number of covered employees is not large enough to allow for the prediction of the frequency of loss, the mortality and morbidity rates may be so high as to eventually bankrupt the plan.

In the late 1970s several large METs in California and Illinois went bankrupt as a result of improper financial reserving practices by their administrators. These bankruptcies gave rise to serious concerns about the lack of authority of state insurance regulators to protect the public in light of ERISA's preemption of state laws. This concern resulted in an amendment to ERISA, enacted in 1982, which is intended to allow states to regulate reserves and contribution levels and to apply existing enforcement procedures to insured "multiple employer welfare arrangements" (MEWAs).

Under the 1982 amendment, less than fully insured MEWAs are potentially subject to the full range of state insurance laws, to the extent not inconsistent with Title I of ERISA, but it is left to the Secretary of Labor to determine by regulation, on an individual or class basis, the extent to which state insurance regulations shall apply. To date, such regulations have not been issued.

The end result of the 1974 preemption language and the 1982 attempt to improve upon it is an uneven, inconsistent and confusing regulatory scheme. Fully insured MEWAs are subject to certain state insurance laws regulating their solvency. MEWAs which are not fully insured are subject to an unknown level of state regulation, pending action by the Secretary. Non-insured single employer plans remain essentially unregulated. Importantly, single employer plans which provide their employees benefits through the purchase of insurance appear to be the only class which must continue to buy a product fully regulated by the states.

We have found no evidence in ERISA or its legislative history that Congress intended its provisions to discourage insured employee benefits. Yet, this situation puts insured health benefits at a sizeable disadvantage in the highly competitive employee benefits marketplace. Regulation creates costs which must be carried by the insurance product. Further, employers with workers in several states face the cost and administrative complexity of providing differing benefits to their employees as dictated by the states in which those employees reside. These burdens can be avoided through self-funding.

In order to improve the serious regulatory imbalance between insured and self-funded employee welfare benefits, the Blue Cross and Blue Shield Association and all of its non-profit member Plans believe it is necessary to amend section 514 of ERISA. With respect to state laws which dictate the benefit content of insurance rather than the solvency and business practices of insurers, we urge that such laws be preempted insofar as they apply to employee benefit plans.[1] This will provide for insured plans the same freedom in benefit design that has long been afforded self-funded plans under section 514.

This is precisely the solution which the federal government adopted for its 5 million employees and dependents in 1978 when it preempted most state benefit mandates insofar as they apply to the insured benefits provided under the Federal Employee Health Benefits Act.[2]

We are aware that there is pending before the United States Supreme Court an appeal which could significantly affect current interpretations of ERISA's preemptive effect upon state regulation.[3] The Court's decision in that case may resolve many of the issues which have arisen from lower courts' interpretations of the language of section 514, but we believe that a complete remedy will most likely require action by the Congress. We recommend, therefore, that, following the Supreme Court decision, your committee conduct a comprehensive and in-depth study of its effect and the many problems which may continue to flow from ERISA's preemption provisions, and produce findings and recommendations for further amendments to the law.

---

1. Specifically, mandated benefit, freedom-of-choice and continuation/conversion laws.

2. P.L. 95-368, September 17, 1978.

3. Metropolitan Life Insurance Co. v. Commonwealth of Massachusetts; The Travelers Insurance Co. v. Commonwealth of Massachusetts, argued before U.S. Supreme Court, February 26, 1985.

Summary

In conclusion, we want to emphasize the value of using tax policy to encourage the private sector to provide benefits which protect our citizens from economic insecurity. With respect to health benefits, we strongly recommend that Congress not impose a tax cap or other form of tax on employee health benefits. Such a tax is not needed and would hurt those most in need of health care.

In order to improve the serious regulatory imbalance between insured and self-funded employee welfare benefits, the Blue Cross and Blue Shield Association believes it is necessary to amend section 514 of ERISA. With respect to state laws which dictate the benefit content of insurance rather than the solvency and business practices of insurers, we urge that such laws be preempted insofar as they apply to employee benefit plans. This will provide for insured plans the same freedom in benefit design that has long been afforded self-funded plans under section 514.

STATEMENT OF COMMITTEE OF ANNUITY INSURERS

The Committee of Annuity Insurers, a coalition of 25 of the leading annuity writers in the United States, appreciates this opportunity to advise the Subcommittee on Labor-Management Relations of our views with respect to the need for a national retirement income policy. Our Committee, a list of the member companies of which is attached, was formed in 1981 to monitor legislative and regulatory issues affecting the annuity industry and annuity policyholders.

The Committee of Annuity Insurers applauds the decision of the Subcommittee on Labor-Management Relations to step back from the legislative activity of the past years and consider the long-term effects of changes in the treatment of retirement programs and retirement products. In the press release announcing the hearings on national retirement income policy, the Subcommittee listed a number of questions to be addressed during its deliberations on this issue. The Committee of Annuity Insurers would like to focus its comments specifically on question No. 2 from that list: "What should be the essential components of a national retirement income policy." We believe that a full and open debate on this question is long overdue.

Unfortunately, Congress has not kept this important question in mind in formulating legislation, and as a result the approach to retirement income policy in this country has been fragmented and inconsistent. During the past four years, Congress has enacted two major tax bills containing provisions which altered the tax treatment of retirement benefits and retirement products, including the tax treatment of annuity contracts. These changes have been piecemeal and in rapid succession, serving as a method for raising revenue rather than articulating a national retirement income policy. The net effect of these changes has been to create great uncertainty in the market for retirement income products and to lessen their attractiveness to younger groups (i.e., those most in need of an alternative retirement vehicle).

The Committee of Annuity Insurers believes that the essential components of a national retirement policy should include (1) employer provided pension programs, (2) personal retirement savings products, such as annuity contracts, and (3) the Social Security system. We would like to expand further on the need for one component of this "three-legged" stool approach -- personal retirement savings.

One of the greatest fears expressed by policyholders (both old and young) is the real or perceived inadequacy of Social Security to (1) cope with the effects of inflation for those already retired and (2) to provide any benefit at all for those whose current contributions are counted on to carry the system. As recent events have shown, a financially sound Social Security system alone cannot ensure that a worker's retirement years will be free from financial worry. It is critical, then, to support savings programs which bridge the income gap between Social Security and an adequate retirement income. The annuity product is especially suitable for providing such supplemental income for an individual and his or her family during retirement years. With an annuity, an individual is guaranteed that he or she can receive an income for life, thereby eliminating the risk and the fear of out-living one's income. Because of this, an annuity has been characterized as the most certain, convenient, and complete protection against dependency available to an individual today. Thus, annuities should be fully permitted to play their evolving role in retirees' income planning.

While the Committee of Annuity Insurers strongly supports the Subcommittee's reexamination of retirement income policy, we believe that any discussion of this issue must include an awareness of the impact which the various tax reform proposals now under consideration by the Congress and the Administration will have on one leg of the "three-legged stool"--private retirement savings. In particular, we are deeply troubled over the treatment of deferred annuity contracts in the Treasury Department proposal on "Tax Reform for Fairness, Simplicity, and Economic Growth."

Under the Treasury proposal, an annuity policyholder would be taxed currently on the interest credited to his or her contract (the so-called "inside build-up") even though such policyholder has not received these amounts either directly or constructively. Such a drastic change in the long-standing tax treatment of annuity contracts is unwarranted and is contrary to both a sound tax policy and a national retirement income policy. In 1978, Congress took a look at taxing the inside build-up on annuity contracts and rejected it. This Congress should do likewise.

The annuity contract is not a tax avoidance device. The premiums for a nonqualified annuity are paid in after-tax dollars (i.e., such premiums are not deductible from gross income). Furthermore, current law does not allow interest on annuities to escape tax--it only permits a deferral of tax. All income credited to the contract is eventually taxed on retirement at ordinary income rates.

In 1982 and again in 1984, Congress, after extensive review, made substantial changes to the tax treatment of annuities in order to ensure that such contracts are utilized for long-term investment and retirement purposes. As a result of these changes, if a policyholder makes a premature withdrawal from an annuity contract, the amount withdrawn is considered to come first from currently taxable income and then from the investment in the contract. In addition, with certain limited exceptions, a substantial penalty of five percent is imposed on withdrawals from the contract prior to the taxpayer reaching age 59 1/2. For these purposes, a loan against, or pledge of, the annuity contract is treated as a taxable distribution. Furthermore, to curb any potential for continuing deferral of tax after the death of the annuity policyholder, a provision was added in 1984 requiring that (except in the case of a surviving spouse) distributions under the contract be made upon the policyholder's death.

Our experience has shown that the changes enacted in 1982 and 1984 ensure, as Congress intended, that annuities are used for their basic purpose--to provide for the long-term retirement needs of the American people. Hence, the fundamental objection to deferred annuities raised by Treasury in its Tax Reform proposal--that they can be used like a bank account to shelter short-term investments --has already been addressed by Congress. There is no evidence that additional changes are needed at this time.

SUMMARY

The Committee of Annuity Insurers urges members of this Subcommittee and of this Congress to reject the Treasury proposal to tax the inside build-up on annuity contracts. Rather than discouraging retirement savings as the Treasury proposal does, this Congress should enact laws which encourage Americans to provide for their own financial security.

National social and tax policy should encourage such self-reliance, for it is abundantly clear that employer provided retirement plans and/or Social Security cannot meet all individual and family retirement needs. Therefore, it is critical that before Congress makes any more changes with respect to the treatment of retirement products, it carefully consider the fundamental objectives of annuity products, taking into account their economic and social values. We firmly believe that products, such as annuity contracts, which encourage retirement savings, are justified as a fundamental component of any national retirement income policy.

COMMITTEE OF ANNUITY INSURERS

Aetna Life & Casualty Insurance Company

American General Life

American International Group

Anchor National Life

Capitol Holding Corporation

Capital Life Insurance Company

Charter Insurance Group, Inc.

Church Life Insurance Corporation

CIGNA Corporation

Equitable Life Assurance Society of the United States

Family Life Insurance Company

Fireman's Fund Insurance Company

Guardian Life Insurance Company of America

Hartford Life Insurance Company

IDS Life Insurance Company

Integrated Resources Life Companies

Kemper Life Insurance Companies

Keystone Provident Life Insurance Company

Life Insurance Company of the Southwest

National Benefit Life Insurance Company

Nationwide Life Insurance Company

New York Life Insurance Company

Northwestern National Life Insurance Company

Sun Life of Canada

Travelers Insurance Companies

April, 1985

Survey of Plan Design and Experience in 401(k) Salary Reduction Plans

PREPARED BY THE STAFF OF HEWITT ASSOCIATES

1985 Edition

Hewitt Associates

INTRODUCTION

History of 401(k)

Section 401(k) salary reduction plans are, in part, an outgrowth of savings and thrift plans, which first appeared in the 1950's. Under Section 401(a) of the Internal Revenue Code, savings and thrift plans are able to qualify for certain tax advantages. Employee contributions are made on a **post-tax** basis. Employer matching contributions and investment earnings, however, are not taxable until the employee receives a distribution from the plan.

The addition of Section 401(k) to the Internal Revenue Code in 1978 and the proposed regulations which followed in 1981 permit employees to make **pre-tax** contributions to profit sharing or stock bonus plans. Such deferrals--as well as employer contributions and investment earnings--are not taxable until the employee receives a distribution from the plan.

Survey of 401(k) Salary Reduction Plans

During the past three years, Section 401(k) salary reduction plans have grown faster than any other employee benefit. In response to the widespread popularity of 401(k), Hewitt Associates conducted an in-depth survey of salary reduction plans in order to provide more data on plan design and experience.

Over 400 U.S. employers were asked to provide data on 401(k) plan design characteristics and plan experience. Survey responses were received from 195 companies, representing 199 different 401(k) plans.[1] Plan design data is current as of January 1, 1985; plan experience data represents the annual results of 1984.

Section I of the report examines plan participation levels and average deferral percentages in 401(k) plans. The relationship between plan design and plan experience is also discussed. The results of this analysis have been tabulated using both simple and weighted averaging techniques.

Section II examines the plan design characteristics in salary reduction plans. Particular attention is paid to employer matching contributions and loan and hardship withdrawal provisions.

The Appendix provides a complete list of survey participants.

---

[1] 191 companies each reported data on one plan; four other companies reported data on separate 401(k) plans for management and nonmanagement employees.

HIGHLIGHTS OF 1985 SURVEY OF 401(k) SALARY REDUCTION PLANS

Hewitt Associates conducted a survey of Section 401(k) salary reduction plans in January and February 1985. Survey data was received by 195 companies, representing 199 401(k) salary reduction plans. The total employee workforce at these companies is just over 5 million employees, of which approximately 3 million are eligible to participate in 401(k) plans. Most survey companies employ between 5,000 and 50,000 workers. Very few of the survey companies have total workforces under 2,000 employees or over 75,000 employees. On average, survey companies employ 26,000 workers, of which 15,000 are eligible to participate in 401(k) salary reduction plans.[1] From this database, Hewitt Associates made the following observations:

PLAN PARTICIPATION

- **75%** of eligible employees are participating on either a pre-tax or post-tax basis in the average 401(k) plan.

- **60%** of eligible employees are participating on a pre-tax basis only in the average 401(k) plan.

- 401(k) plans with an employer matching provision have 9% higher pre-tax participation than plans without an employer match.

- 401(k) plans with a hardship withdrawal have 9% higher pre-tax participation than plans without hardship withdrawal.

- 401(k) plans with a loan provision have 6% higher pre-tax participation than plans without loan provision.

- 401(k) plans with both loan and withdrawal provisions have 7% higher pre-tax participation than plans with either just loan or withdrawal provisions.

---

[1] Survey data suggests that the groups most typically not eligible to participate in 401(k) plans are union employees, and to a lesser extent, part-time employees. Some plans also exclude employees not satisfying eligibility requirements with respect to age and service.

HIGHLIGHTS OF 1985 SURVEY OF 401(k) SALARY REDUCTION PLANS (continued)

Previous survey data, although limited, suggests that a 75% participation rate is relatively high when compared to other retirement savings plans that do not have a salary reduction feature. Hewitt Associates' 1984 Survey of 401(k) Salary Reduction Plans compared participation levels in companies prior to and after the implementation of a 401(k) salary reduction provision. In two-thirds of the cases (68%), participation levels were found to be higher in 401(k) plans than in the previous post-tax savings vehicles.

Data provided in this survey suggests that one reason pre-tax participation levels (60%) are 15 percentage points lower than pre- and post-tax participation (75%) is the relative lack of accessibility of the pre-tax savings amounts. When pre-tax contributions are made more accessible to plan participants through either a loan or a withdrawal provision, pre-tax participation levels were found to be higher.

There also appeared to be a relationship between the existence of an employer matching provision and higher participation levels.

Plan Participation (Low-Paid 2/3, High-Paid 1/3)

- **53.9%** of eligible employees in the low-paid 2/3 are participating on a pre-tax basis.
- **72.9%** of eligible employees in the high-paid 1/3 are participating on a pre-tax basis.

Survey data shows that at higher levels of pay, pre-tax participation rates are generally higher. The data also shows that in the average plan, over half of the eligible employees, both in the low-paid 2/3 and high-paid 1/3, are making pre-tax contributions. The average breakpoint between low-paid 2/3 and high-paid 1/3 for the survey group is approximately $30,000.

HIGHLIGHTS OF 1985 SURVEY OF 401(k) SALARY REDUCTION PLANS (continued)

A study jointly-sponsored by the Employee Benefit Research Institute (EBRI), and the Department of Health and Human Services (HHS) showed that **age** appears to have more of a relationship to 401(k) pre-tax participation than does pay. Pre-tax participation levels for employees under age 35 were shown to be quite low. Conversely, at age 50 and above, a majority of eligible participants were found to be making pre-tax contributions. The difference in pre-tax participation at various pay levels tended to be less dramatic.

Average Deferral Percentages (Eligible Employees)

- An average of **3.4%** of salary is being deferred by low-paid 2/3 employees.
- An average of **5.4%** of salary is being deferred by high-paid 1/3 employees.

The figures shown above represent average deferral contributions made as a percentage of pay for all employees eligible to participate in 401(k) salary reduction plans. Each company must tabulate these numbers to make sure their 401(k) plan is in compliance with the IRS nondiscrimination rules. The "zeroes" of nonparticipating employees must be included in these calculations.

Average Deferral Percentages (Participating Employees Only)

- An average of **6.3%** of salary is being deferred by the low-paid 2/3.
- An average of **7.4%** of salary is being deferred by the high-paid 1/3.

The figures shown above indicate that among those employees actually making pre-tax contributions, there is very little difference in the percentage of salary being deferred by the low-paid 2/3 and high-paid 1/3. This indicates that it is the nonparticipating employees in the low-paid 2/3 that are mainly responsible for the difference in average deferral percentages.

HIGHLIGHTS OF 1985 SURVEY OF 401(k) SALARY REDUCTION PLANS (continued)

PLAN DESIGN

Employer Matching Provision

- **84%** of 401(k) plans have an employer matching provision.
- The majority of plans match at a rate of at least **$.50** per $1.00.
- The company match applied to a maximum of **6%** of salary on average.

Loan Provision

- **35%** of 401(k) plans have a loan provision.
- The average loan interest rate is **11.6%**.
- The average company has **15%** of participants with a loan outstanding.

Hardship Withdrawal Provision

- **87%** of 401(k) plans have a hardship withdrawal provision
- The typical plan allows hardship withdrawal **only for**:
  (1) purchase of primary residence,
  (2) education of family member, or
  (3) uninsured medical expenses.

PLAN EXPERIENCE IN 401(k) PLANS

Pre- and Post-Tax Participation

Table 1 examines the level of pre- and post-tax participation in the 195 401(k) plans that reported such data. Average participation rates have been computed using both simple and weighted averaging techniques.

In calculating simple averages, each 401(k) plan is weighted equally, without regard to the number of employees. In contrast, a weighted average is determined by first calculating the total number of eligible employees, and then weighting the average reported by each plan on the basis of the number of eligible employees in that plan relative to the total number of eligible employees in the survey.

Table 1 shows that in the average 401(k) salary reduction plan, 75% of eligible employees are participating on either a pre-tax or post-tax basis. With respect to the 2.8 million eligible employees in these 195 plans, the total number participating pre- and post-tax is nearly 2 million (70%).

Table 1
Summary of Pre- and Post-Tax Participation

Survey Group	Averaging Technique	Pre- and Post-Tax Participation
195 plans	Simple (per plan)	75%
2,796,610 eligible employees	Weighted (per eligible employee)	70%

Pre-Tax Only Participation

Table 2 focuses only on 401(k) pre-tax participation. Again, participation rates have been computed using both simple and weighted averaging techniques. The table shows that the majority of people are using 401(k) salary reduction plans to save on a pre-tax basis.

Table 2

Summary of Pre-Tax Participation

Survey Group	Averaging Technique	Pre-Tax Participation
198 plans	Simple (per plan)	60%
2,811,627 eligible employees	Weighted (per eligible employee)	56%

Pre-Tax Participation: Low-Paid 2/3, High-Paid 1/3

Information on plan participation rates of the low-paid 2/3 employees and high-paid 1/3 employees was provided for 160 401(k) plans. An average of these two participation rates has been computed using both simple and weighted averaging techniques.

For both the low-paid 2/3 and high-paid 1/3 groups, the weighted average participation rates are lower than the simple averages. However, the differential between the low- and high-paid for both techniques is roughly the same.

One reason the weighted averages tend to be lower is that several large employers (more than 25,000 eligible employees) reported unusually low participation rates. Nearly all of these plans also have a post-tax savings option that is achieving a high level of participation.

Table 3
Summary of Pre-Tax Participation
In Low-Paid 2/3, High-Paid 1/3

Survey Group	Weighting Technique	Plan Participation Lo-Paid 2/3	 Hi-Paid 1/3
160 plans	Simple (per plan)	53.9%	72.9%
2,525,771 eligible employees	Weighted (per eligible employee)	45.5%	67.1%

Average Deferral Percentages (All Eligible Employees)

Information on the average deferral percentage of the low-paid 2/3 and the high-paid 1/3 of all eligible employees was provided for 192 plans. These are the same numbers used to test compliance with the IRS nondiscrimination test. (The zeroes of nonparticipating employees are included in these numbers.) For 37 plans these numbers include employer funds (e.g., discretionary or profit sharing contributions). Percentages were calculated using both simple and weighted averaging techniques.

Table 4 shows that the low-paid 2/3 typically defer in the vicinity of 3.0% of pay and high-paid 1/3 approximately 5.0% of pay. Again, the weighted averages tend to be slightly lower.

Table 4
Summary of Average Deferral Percentages
In Low-Paid 2/3 and High-Paid 1/3
(All Eligible Employees)

Survey Group	Averaging Technique	Average Deferral Percentage	
		Lo-Paid 2/3	Hi-Paid 1/3
192 plans	Simple (per plan)	3.4%	5.4%
2,807,717 eligible employees	Weighted (per eligible employee)	3.0%	4.7%

Average Deferral Percentages (Participating Employees)

Table 5 examines the average deferral percentage of the low-paid 2/3 and high-paid 1/3 only among those employees that actually made 401(k) contributions. In doing so, the zeroes being contributed by nonparticipating employees are removed, although it is important to note that the two groupings of employees do not change.

In this analysis the data shows that the difference between the percentages of salary being deferred by the low-paid 2/3 and the high-paid 1/3 is much smaller. The data compression is especially pronounced in the case of the weighted averages where the difference between the two groups is only 0.4%.

Table 5
Summary of Average Deferral Percentages
For Low-Paid 2/3 and High-Paid 1/3
(Participating Employees Only)

Survey Group	Averaging Technique	Average Deferral Percentage	
		Lo-Paid 2/3	Hi-Paid 1/3
192 plans	Simple (per plan)	6.3%	7.4%
1,809,412 participating employees	Weighted (per participating employee)	6.6%	7.0%

Pay Breakpoint Between Low-Paid 2/3 and High-Paid 1/3 Groups

Information concerning what pay level separates the low-paid 2/3 of employees from the high-paid 1/3 of employees was received for 185 401(k) salary reduction plans. Although the data range is quite wide ($10,541-$48,360), the majority of responses are concentrated between $25,000-$34,000.

Table 6
Pay Breakpoints
Between the Low-Paid 2/3 and
the High-Paid 1/3 Employee Groups

Survey Profile	Breakpoint
Highest	$48,360
Upper quartile	34,000
Median	30,000
Lower quartile	25,000
Lowest	10,541
Average plan	$29,325

Plan Experience by Pay Level

Survey participants were also asked to provide information on pre-tax plan participation rates and average deferral percentages by pay level. Survey responses to this question were received for 51 plans in which over 400,000 employees were eligible for 401(k) salary deferral contributions.

Respondents were encouraged to use whatever pay brackets were most accessible for their own data. The pay brackets most frequently used by survey respondents, and the number of eligible employees in each of these brackets, are shown in the first and second columns in Table 7.

The two columns under Pre-Tax Participation show participation rates among eligible employees. The first column is the participation rate within each pay bracket. The second column is the participation for that pay bracket as a function of all eligible employees. For example, in the Over $60,000 pay bracket, 87% of employees participate on a pre-tax basis, but they make up only 7% of all eligible employees.

The last column in the table examines the average deferral percentages made as a percentage of pay for all eligible employees. The "zeroes" of nonparticipating employees are included in these calculations. The survey data shows a gradual rise in deferral percentages as pay increases. The average deferral percentage for the survey group is 4.6% of pay.

Table 7
Plan Experience by Plan Level

Pay Bracket	Number of Eligible Employees	Pre-Tax Participation (as % of eligible employees in pay brackets)	Pre-Tax Participation (as % of total eligible employees)	Avg. Deferral Percentage
Under $15,000	45,000	39%	8%	3.2%
$15,000-$30,000	65,000	52%	16%	3.8%
$30,000-$45,000	50,000	68%	16%	4.8%
$45,000-$60,000	35,000	74%	12%	5.9%
Over $60,000	15,000	87%	7%	7.4%
	210,000		59%	

Note: The total number of eligible employees in this table is considerably less than the total number reported for the 51 401(k) plans providing this information. There are two reasons for this. First, because of the wide range of pay brackets used by survey participants, no one set of brackets can capture all of this information. As such, only survey responses providing pay bracket data that are compatible with the pay brackets shown above have been used. Secondly, for the purpose of this analysis, the number of eligible employees used from a single plan has been limited to 10% of the total number of eligible employees. Therefore, no one company can have too heavy an influence on the survey data.

Relationship of Plan Design Characteristics and Plan Experience

Survey data provided for 199 401(k) salary reduction plans has also been examined to determine the existence of relationships between plan design characteristics and plan experience (participation levels and average deferral percentages).

Table 8 (pages 15-16) uses a simple averaging technique to reflect participation levels and average deferral percentages at the average company.

Table 9 (pages 17-18) uses a weighted averaging technique. Plan experience data is weighted on the basis of the number of eligible employees (i.e., the data for companies with a large number of employees are weighed more heavily than the data with fewer employees). As such, the numbers reflect participation levels and average deferral percentages for all eligible employees.

Each of the two tables examines the relationship between the same plan design characteristics and the same independent variables.

Independent Variables (Plan Experience): The summary tables focus on three independent variables on plan experience data: (a) pre-tax plan participation rates for low-paid 2/3, high-paid 1/3; (b) average salary deferral rates for eligible employees in low-paid 2/3, high-paid 1/3; (c) average salary deferral rates for participating employees only in low-paid 2/3, high-paid 1/3 (zeroes of nonparticipating employees are excluded).

The first two columns ("Survey Prevalence") show the number of survey plans (Table 8) or the number of eligible employees (Table 9) that have a particular plan design characteristic. The column before plan participation data and before average deferral data shows the number of companies that were able to provide information on such data.

Dependent Variables (Plan Design): In examining the relationship between plan design and experience, several plan characteristics were examined. The first row ("Total Survey") examines plan experience data for all 199 401(k) plans--regardless of plan design. All other rows represent subsets of the total survey group. Five plan design characteristics in particular are studied:

(1) plans with an employer matching provision,
(2) plans with a loan provision,
(3) plans with withdrawal provisions,
(4) maximum salary reduction of 401(k) plans, and
(5) new 401(k) plans (and those converted from pre-existing post-tax plans).

Data Analysis: Several observations can be made from the summary tables. It appears that the existence of an employer matching provision, a loan provision, and a withdrawal provision all correspond to higher participation levels than plans without these features. Also, 401(k) salary reduction plans that were conversions from existing post-tax savings plans achieve higher participation levels than new plans. The maximum salary reduction allowed by a plan does not seem to significantly affect participation levels.

In general, average salary deferral percentages do not appear to have as strong a relationship to plan design characteristics. However, plans with higher matched salary reduction levels and higher total maximum salary reduction levels did experience higher salary deferral rates.

Table 8
401(k) Plan Experience: Per Plan (Simple) Averages

	Survey Prevalence By Plan*		Pre-Tax Plan Participation Rates		
	Number	Percent	No. of Plans In Data	Low-Paid 2/3	High-Paid 1/3
I. Total Survey	199	100.0%	160	53.9%	72.9%
II. Effect of Employer Matching Contributions					
A. No Employer Match	31	15.6	27	45.9	66.5
1. And No Company Contribution	14	7.0	13	46.8	67.8
2. But With Company Contribution	17	8.5	14	45.1	65.4
B. With Employer Match	168	84.4	133	55.5	74.1
1. Rate of Match (per $1) (Selected Subgroups)					
a. 25¢-40¢	15	7.5	14	56.6	78.2
b. 50¢	65	32.7	51	53.1	74.5
c. 60¢-75¢	10	5.0	7	40.8	64.2
d. $1 or More	24	12.1	15	62.9	79.0
2. Maximum Matched Salary Reduction (Selected Subgroups)					
a. 2%-3% of Salary	21	10.6	16	48.4	68.0
b. 4%-5% of Salary	41	20.6	29	54.2	71.9
c. 6% of Salary	84	42.2	70	57.9	77.3
d. 7%-10% of Salary	12	6.0	11	51.1	67.3
III. Effect of Loan Provision					
A. Without Loan Provision	127	63.8	102	51.8	70.9
B. With Loan Provision	70	35.2	56	57.5	76.2
IV. Effect of Withdrawal Provision					
A. Without Hardship Withdrawal	19	9.5	13	47.4	66.8
B. Hardship Withdrawal Provision, But Not Yet Implemented	7	3.5	6	38.4	60.0
C. With Hardship Withdrawal	173	86.9	141	55.1	80.0
V. Effect of Total Maximum Salary Reduction (Selected Subgroups)					
A. 4%-9% of Salary	60	30.2	50	54.3	74.9
B. 10% of Salary	47	23.6	39	54.6	69.5
C. 10.5%-15% of Salary	50	25.1	35	53.8	72.4
D. 16% of Salary	32	16.1	29	55.0	76.1
VI. Effect of New Plan					
A. New Plan	35	17.6	27	54.0	72.3
B. Converted Existing Plan	139	69.8	112	51.7	71.6

---

*Groupings do not always total 100%, as data for some companies is not available.

Average Deferral Percentages			Average Deferral Percentages Participating Employees Only	
No. of Plans in Data	Low-Paid 2/3	High-Paid 1/3	Low-Paid 2/3	High-Paid 1/3
192	3.4%	5.4%	6.3%	7.4%
30	3.3	5.1	7.2	7.7
14	2.7	4.7	5.8	6.9
16	3.7	5.5	8.2	8.4
162	3.5	5.4	6.3	7.3
15	3.3	5.2	5.8	6.6
62	3.4	5.3	6.4	7.1
10	3.2	5.3	7.8	8.3
24	3.6	5.6	5.7	7.1
21	3.2	5.1	6.6	7.5
39	3.1	5.0	5.7	7.0
81	3.5	5.6	6.0	7.2
11	4.1	6.1	8.0	9.1
122	3.2	5.1	6.2	7.2
68	3.8	5.8	6.6	7.6
18	3.1	5.0	6.5	7.5
7	2.7	4.8	7.0	8.0
167	3.5	5.4	6.4	6.8
58	3.0	4.6	5.5	6.1
46	3.5	5.5	6.4	7.9
47	3.6	5.6	6.7	7.7
31	3.7	6.0	6.7	7.9
34	3.4	5.0	6.3	6.9
133	3.4	5.3	6.6	7.4

Table 9
401(k) Plan Experience: Eligible Employee (Weighted) Averages

	Survey Prevalence By Eligible Employees*		Pre-Tax Plan Participation Rates		
	Number	Percent	No. of Eligible Employees In Data	Low-Paid 2/3	High-Paid 1/3
I. Total Survey	2,892,002	100.0%	2,525,771	45.5%	67.1%
II. Effect of Employer Matching Contributions					
A. No Employer Match	470,937	16.3	401,949	40.8	61.4
1. And No Company Contribution	195,476	6.8	160,476	32.2	56.6
2. But With Company Contribution	295,461	10.2	240,473	46.5	64.6
B. With Employer Match	2,421,065	83.7	2,123,822	46.4	68.2
1. Rate of Match (per $1) (Selected Subgroups)					
a. 25¢-40¢	177,489	9.9	173,189	45.1	69.2
b. 50¢	999,813	5.7	907,271	39.3	63.2
c. 60¢-75¢	165,258	34.6	151,105	31.6	58.9
d. $1 or More	287,742	6.1	159,906	63.5	79.4
2. Maximum Matched Salary Reduction (Selected Subgroups)					
a. 2%-3% of Salary	246,529	8.5	163,696	45.2	70.7
b. 4%-5% of Salary	678,985	23.5	588,476	50.3	71.4
c. 6% of Salary	882,180	30.5	817,034	46.3	69.3
d. 7%-10% of Salary	262,557	9.1	259,128	58.4	76.3
III. Effect of Loan Provision					
A. Without Loan Provision	1,877,331	64.9	1,658,877	44.0	65.6
B. With Loan Provision	1,003,921	34.7	856,144	48.4	70.0
IV. Effect of Withdrawal Provision					
A. Without Hardship Withdrawal	521,259	18.0	460,103	54.2	73.5
B. Hardship Withdrawal Provision, But Not Yet Implemented	330,883	11.4	329,993	20.1	44.4
C. With Hardship Withdrawal	2,039,860	70.5	1,735,675	48.0	69.8
V. Effect of Total Maximum Salary Reduction (Selected Subgroups)					
A. 4%-9% of Salary	602,678	20.8	567,763	47.6	70.2
B. 10% of Salary	749,130	25.9	650,218	55.4	73.4
C. 10.5%-15% of Salary	836,803	28.9	650,427	48.2	67.7
D. 16% of Salary	367,353	12.7	350,057	40.7	66.0
VI. Effect of New Plan					
A. New Plan	506,502	17.5	479,077	41.6	61.5
B. Converted Existing Plan	2,238,524	77.4	1,951,151	46.1	68.2

---

*Groupings do not always total 100%, as data for some companies is not available.

	Average Deferral Percentages		Average Deferral Percentages (Participating Employees Only)	
No. of Employees Reported	All Eligible Employees			
	Low-Paid 2/3	High-Paid 1/3	Low-Paid 2/3	High-Paid 1/3
2,807,717	3.0%	4.7%	6.6%	7.0%
439,937	2.3	4.1	5.6	6.7
195,476	1.8	3.9	5.6	6.9
295,461	2.6	4.3	5.6	6.7
2,367,780	3.1	4.8	6.7	7.0
177,489	2.5	4.4	5.5	6.4
987,559	3.1	4.7	7.9	7.4
165,258	2.4	4.8	7.6	8.1
287,742	3.6	5.5	5.7	6.9
246,529	2.7	4.6	6.0	6.5
641,353	3.1	4.8	6.2	6.7
869,956	3.1	4.9	6.7	7.1
259,128	4.9	7.1	8.4	9.3
1,829,203	2.7	4.4	6.1	6.7
967,764	3.5	5.4	7.2	7.7
485,260	3.2	4.7	5.9	6.4
330,833	1.2	2.8	6.0	6.3
1,991,574	3.2	5.1	6.7	7.3
597,616	2.5	4.0	5.3	5.7
713,131	3.3	5.2	6.0	7.1
798,736	3.4	5.4	7.1	8.0
362,196	3.5	5.1	8.6	7.7
504,869	2.3	3.6	5.5	5.9
2,155,872	3.1	4.9	6.7	7.2

PLAN DESIGN CHARACTERISTICS IN 401(k) PLANS

Types of Savings Methods In 401(k) Plans

Focusing first on plan design from a broad perspective, Table 10 shows that over three-fourths (78%) of all salary reduction plans allow the opportunity for pre-tax and post-tax savings. Only 22% of the plans restrict participants to just pre-tax salary deferral contributions.

Table 10
Types of Savings Methods
In Salary Reduction Plans

Type of Plan	Percent of 199 Plans
Pre-tax savings only	22%
Pre-tax and post-tax savings	78%
	100%

Prevalence of Employer Match

As Table 11 shows, the great majority of salary reduction plans include an employer matching contribution.

Table 11
Prevalence of Employer Match

Employer Matching Contribution	Number of Plans	Percent of Plans
Yes	168	84%
No	31	16%
	199	100%

Of the 31 plans that do not provide an employer match, 17 of these plans (55%) have an alternative type of employer contribution, such as a discretionary or profit sharing contribution, which is not directly based on employee salary deferral amounts.

Of the 199 401(k) plans, only 14 (7%) have no company money (e.g., a matching provision or discretionary or profit sharing donation) being contributed toward their 401(k) salary reduction plans.

Rate of Employer Match

Concentrating on the 168 plans that provide an employer match for salary reduction contributions, Table 12 examines the rate of employer matching contributions. Among these companies, the most common match is $.50 per $1.00; however, 21% provide a match greater than $.50 per $1.00.

Table 12
Employer Matching Contribution
in Plans With Employer Match

Employer Match Per Dollar	Percent of 168 Plans
Less than $.50	9%
$.50	39%
$.51-.99	6%
$1.00	14%
More than $1.00	1%
Profit-related	16%
Other (e.g., varies by years of participation, or varies by amount contributed)	15%
	100%

Maximum Level of Employee Salary Reduction

Table 13 shows the maximum level of matched pre-tax contributions in the 168 plans with a matching provision. Exactly half of these plans match salary reduction contributions up to 6% of salary. Only 7% of the plans in this group match salary deferrals that exceed 6% of pay.

Table 13
Maximum Level of Matched Salary Reduction
In Plans With Employer Match

Maximum Level of Matched Salary Reduction	Percent of 168 Plans
2% of pay	4%
3% of pay	8%
4% of pay	9%
5% of pay	16%
6% of pay	50%
7% of pay	1%
8% of pay	4%
9% of pay	--
10% of pay	2%
Other (e.g., flat dollar amount, % of pay plus flat dollar amount)	6%
	100%

Again focusing on the 168 salary reduction plans that include an employer matching contribution, Table 14 shows the maximum level of total (matched plus unmatched) pre-tax contributions that are allowed. More than two-thirds (68%) of the employers in this group allow total (matched plus unmatched) contributions of at least 10% of pay.

Table 14
Maximum Level of Salary Reduction
In Plans With Employer Match

Maximum Level of Total Salary Reduction	Percent of 168 Plans
4% of pay	1%
5% of pay	5%
6% of pay	14%
7% of pay	3%
8% of pay	7%
9% of pay	1%
10% of pay	21%
11% of pay	2%
12% of pay	7%
13% of pay	3%
14% of pay	4%
15% of pay	10%
16% of pay	19%
Over 16% of pay	2%
Other (e.g., flat dollar amount, % of pay plus unused flexible credits)	1%
	100%

Table 15 shows the maximum level of salary reduction allowed in the 31 plans that do not provide for an employer matching contribution. The trend of this data does not deviate much from the data found in matched plans; approximately two-thirds (67%) of the plans allow salary reductions of at least 10% of pay.

Table 15
Maximum Level of Salary Reduction
In Plans Without Employer Match

Maximum Level of Total Salary Reduction	Percent of 31 Plans
4% of pay	3%
6% of pay	16%
7% of pay	6%
8% of pay	3%
10% of pay	42%
11% of pay	3%
12% of pay	6%
15% of pay	16%
Other (e.g., % of pay plus flat dollar amount)	5%
	100%

Vesting Schedules

Table 16 illustrates the types of vesting schedules for employer contributions. These employer funds are either matching contributions or discretionary or profit sharing contributions. Data was supplied for 181 plans.

The most common type of vesting is a graded schedule (34%). The most typical graded schedule provides for vesting at a rate of 20% per year of participation to 100% at five years.

Table 16
Vesting Schedules for
Employer Contributions

Type of Vesting	Percent of 181 Plans
Graded (contributions vested on a per year of service/participation basis)	34%
100% Immediate	24%
Class year (contributions vested on basis of year in which they were made)	23%
Cliff vesting (contributions 100% vested after specified length of service/participation)	5%
Other (mixture of any two vesting schedules described above)	14%
	100%

In the 199 401(k) plans surveyed, all employee salary reduction contributions are 100% vested.

Investment Options

Information on the types of investment options available for salary reduction contributions was provided for 184 401(k) plans in this study. Table 17 shows that the great majority of these plans (71%) provide three or more types of investment options for salary reduction contributions.

Table 17
Number of Investment Options for
401(k) Salary Reduction Contributions

Number of Options	Percent of 184 Plans
1	4%
2	25%
3	45%
4 or more	26%
	100%

Table 18 provides information on the number of investment options available for employer contributions to 401(k) plans. This information was provided by 165 plans that provide for either a matching contribution or a profit sharing or discretionary contribution. The table indicates that there is much less choice regarding the investment of employer funds. Nearly half of the plans (46%) offer only one investment option.

Table 18
Number of Investment Options for
Employer Contributions to 401(k) Salary Reduction Plans

Number of Options	Percent of 165 Plans
1	46%
2	16%
3	23%
4 or more	15%
	100%

Table 19 examines the frequency with which certain types of investment options are offered for employee salary reduction contributions. Investment options are ranked in descending order of risk. The three most common choices offered are an equity fund (82%), a GIC (guaranteed interest contract) (66%), and company stock (53%).

Table 19
Types of Investment Options for
401(k) Salary Reduction Contributions

Type of Investment Option	Percent* of 184 Plans
Company stock	53%
Equity fund	82%
Balanced fund	16%
Short-term securities	37%
Bond or fixed income fund	39%
GIC	66%
Life insurance	5%
Other (e.g., government securities, index fund, real estate)	7%

---

*Total exceeds 100% due to multiple options.

Table 20 describes the choice of investment options available for employer contributions. Investment options are ranked in decreasing order of risk. The investment options provided for company money are noticeably distinct from those offered for salary reduction contributions. By far the most popular option for company money is employer stock (71%). This is followed by an equity fund (43%) and a GIC (38%).

Table 20
Types of Investment Options
For Employer Contributions in
401(k) Salary Reduction Plans

Type of Investment Option	Percent* of 165 Plans
Company stock	71%
Equity fund	43%
Balanced fund	13%
Short-term securities	21%
Bond or fixed income fund	22%
GIC	38%
Life insurance	2%
Other (e.g., government securities, index fund, real estate)	5%

---

*Total exceeds 100% due to multiple options.

Loan and Hardship Withdrawal Provisions

Data concerning loan provisions was provided by 197 of the 199 401(k) salary reduction plans. Table 21 shows that just over one-third of these plans have a loan provision. Approximately 10% of those currently without a loan provision are planning to implement one in either 1986 or 1987.

Table 21
Prevalence of Loan Provisions
In 401(k) Salary Reduction Plans

Type of Plan	Number of Plans	Percent of 197 Plans
With loan provision	70	36%
Without loan provision	127	64%
	197	100%

Approximately 15% of 401(k) plans with loan provisions require eligible employees to satisfy some definition of "extreme hardship" before granting a loan application. Four out of five companies (79%) have restrictions concerning the number of loans which can either be outstanding at one time or made in one year.

Nearly all plans (90%) have a minimum loan requirement. The majority of these plans require a $1,000 minimum. With respect to loan maximums, almost half of the plans (46%) allow a participant to borrow all vested funds. Twenty-one companies (30%) permit only the borrowing of employee contributions.

Of the 70 companies with a loan provision, 63 provided information on the rate of interest being charged to participants. The survey data on loan provisions is quite compressed; nearly all of plans are currently using an interest rate between 10-13%.

Table 22
Current Loan Interest Rate
Being Charged on New Loans

Survey Profile	Rate
Highest	14.62%
Upper quartile	12.40
Median	11.75
Lower quartile	10.72
Lowest	7.00
Average plan	11.61%

The method that plans use to determine interest rates was also examined. Information concerning interest rate determination was provided by 55 companies. As can be seen in Table 23, 48% of the plans are basing their interest rate on the rate used by some type of financial lending institution. Almost one-third of the plans are using a more fixed indicator, such as a GIC or government bonds.

Table 23
Interest Rate Determination
In Salary Reduction Plans With Loan Provisions

Factors Used for Interest Rate Determination		Percent of 55 Plans
Established rate of financial institutions		48%
Prime interest rate	22%	
Prime plus 1%	9%	
Prime minus 1% or 2%	7%	
Bank rate (either lending institution or trustee)	9%	
Federal discount rate	1%	
Short-term treasury bills (90-day or 26-week)		5%
Long-term notes or U.S. Government bonds		9%
GIC rate		22%
Multiple factors		7%
Discretionary		3%
Other		6%
		100%

Approximately 60% of the plans reported that the rate of interest being charged to participants comes under consideration for change more than once a year. The other 40% of salary reduction plans consider altering interest rates on an annual or less frequent basis.

Of the 70 companies with loans, 69 were able to provide data on the duration of the interest rates for loans. Sixty-two plans (90%) fix the loan rate at the time of take-down, and it remains fixed for the life of the loan. The other 10% have a floating rate.

Information on the percentage of eligible employees with loans outstanding was provided by 23 401(k) plans. In all cases, the loan provision had been in effect for at least one year. The results shown in Table 24 indicate that in the average company, 15% of eligible employees have loans outstanding.

Table 24
Percent of Eligible Employees
With Loans Outstanding

Percent of Loans Outstanding	Percent of 23 Plans
0-5%	26%
6-10%	22%
11-15%	17%
16-20%	13%
21-30%	13%
Over 30%	9%
	100%
Average plan	15%

As Table 25 shows, the great majority of 401(k) salary reduction plans have a provision for hardship withdrawals. Three percent of the survey plans have a provision for hardship in their plan documents, but will not exercise this provision until final IRS regulations are released.

Table 25
Prevalence of Hardship Withdrawals
in 401(k) Salary Reduction Plans

Type of Plan	Percent of 199 Plans
With hardship withdrawal provision	87%
With hardship withdrawal, but will not be implemented until final IRS rules issued	3%
No provision for hardship withdrawal	10%
	100%

As final IRS regulations have not yet been issued, a great deal of variation exists concerning what constitutes "extreme financial hardship." Information on this issue was provided by 173 companies with a hardship provision. Responses in Table 26 are ranked from the most uncompromising interpretation of extreme hardship to more liberal interpretations. Table 26 shows that nearly half (46%) of the plans are using three specified criteria--purchase of a primary residence, education, and death/sickness in family--to satisfy the definition of extreme financial hardship. A total of 34% of the plans allow these three criteria and also include, in a general sense, the possibility of some other "extreme hardship" (e.g., other catastrophic expenses). Ten percent of the companies are allowing the three criteria described above and are also allowing at least one other specific condition (e.g., divorce) to satisfy their interpretation. Fourteen companies, or 8% of the plans, do not have a pre-established criteria for granting a hardship (e.g., primary residence, education). Requests for hardship are essentially determined on an individual, case-by-case basis.

Table 26
Definition of Hardship
In Plans With Withdrawal Provisions

Definition of Hardship		Percent of 173 Plans
A. Unforeseen financial expenses only--no pre-established criteria		4%
B. Uninsured medical expenses only		2%
C. Loss of property or uninsured medical expenses		2%
D. Purchase of a primary residence, Education of a family member, and Death/sickness in family		46%
E. Choice D plus "other" extreme hardship (e.g., loss of property, casualty, catastrophic expenses)		34%
F. Choice D plus at least one option below:		12%*
-- divorce	5%	
-- legal expenses	4%	
-- loss of job, layoff	3%	
-- remodeling primary residence	2%	
-- repairing primary residence	2%	
-- disability	1%	
		100%

---

*Total exceeds 12% due to multiple options.

Information on loans and withdrawals was provided for 197 401(k) plans. Table 27 shows that 28% of the 197 401(k) salary reduction plans have both a loan and hardship withdrawal provision. Only 11 plans (6%) offer neither a loan nor a hardship withdrawal provision.

Table 27
Prevalence of Loan and Withdrawal Provisions
in 401(k) Salary Reduction Plans

Type of Plan	Number of Plans	Percent of 197 Plans
With withdrawal provision only	116	59%
With loan provision only	14	7%
With both loan and withdrawal provisions	56	28%
With neither loan nor withdrawal provision	11	6%
	197	100%

APPENDIX: SURVEY COMPANIES

AMF Incorporated
Abbott Laboratories
Acacia Mutual Life Insurance Company
Air Products and Chemicals, Inc.
Alexander & Baldwin
Allen-Bradley Company
Allied Corporation
Allstate Insurance Company
American Broadcasting Companies, Inc.
American Electric Power Company, Inc.
American Fletcher Corporation
American Hospital Supply Corporation
American National Bank and Trust Company of Chicago
Ampex Corporation
Analog Devices
The Arizona Bank
Armstrong World Industries, Inc.
Arvin Industries, Inc.
Ashland Oil, Inc.
Associated Dry Goods Corporation
Atlantic Richfield Company

BASF Wyandotte Corporation
Baltimore Gas and Electric Company
Bank of America
Battelle Memorial Institute
Bausch & Lomb, Inc.
The Becker Company, Inc.
Bemis Company, Inc.
The Boeing Company
Boise Cascade Corporation
W. H. Brady Company
Brown-Forman Distiller Corporation
Burroughs Corporation

C.I.T. Financial Corporation
Cargill, Inc.
Castle & Cooke, Inc.
Celanese Corporation
CENEX
Central Illinois Light Company
Colonial Life and Accident Insurance Company
Columbia Gas System Service Corporation
Columbia Pictures Industries, Inc.
Combustion Engineering, Inc.
Commonwealth Edison Company
Compugraphic Corporation
Consumers Power Company

Continental Resources Company
Control Data Corporation
Corning Glass Works
Cox Communications, Inc.
Crocker National Bank
Crown Zellerbach Corporation
Cyclops Corporation

Deere & Company
Dillingham Corporation
The Dow Chemical Company
Dow Corning Corporation

Eagle-Picher Industries Inc.
Eastman Kodak Company
Eaton Corporation
Exxon Coal USA, Inc.

FMC Corporation
Fansteel Incorporated
Federal Signal Corporation
First Bank System, Inc.
First Union Corporation
Ford Motor Company

GATX Corporation
GTE Corporation
GEICO Corporation
General Electric Company
General Foods Corporation
General Host Corporation
General Signal Corporation
Genesco Inc.
Geosource, Inc.
Gerber Products Company
The Gillette Company
The B. F. Goodrich Company
The Goodyear Tire & Rubber Company
W. R. Grace & Co.
Grand Trunk Western Railroad Company
Great Northern Nekoosa Corporation

Hammermill Paper Company
Honeywell Inc.
Household International Corporation

ITT Corporation
Illinois Tool Works Inc.
Ingersoll-Rand Company
Inland Steel Company
Intel Corporation

InterFirst Corporation
IntraWest Financial Corporation
Iowa-Illinois Gas and Electric Company

James River Corporation of Virginia
John Hancock Mutual Life Insurance Company
Johnson & Johnson
Johnson Controls, Inc.
Jostens, Inc.

The M. W. Kellogg Company
Keyes Fibre Co.
Kimberly-Clark Corporation
Kraft, Inc.

Land O'Lakes, Inc.
Levitz Furniture Corporation
Eli Lilly and Company
The Lincoln National Life Insurance Company
Lockheed Corporation

MCO Holdings Inc.
Mack Trucks, Inc.
Manville Corporation
Mattel, Inc.
McDonnell Douglas Corporation
McKesson Corporation
Metropolitan Life Insurance Company
Miles Laboratories, Inc.
The 3M Company
Mitchell Energy & Development Corp.
Mobil Corporation
Modine Manufacturing Company
Mohasco Corporation
Montgomery Ward & Co., Inc.
Morgan Guaranty Trust Company
Morgan Stanley & Company, Inc.
Morton Thiokol, Inc.
Motorola, Inc.
The Mutual Life Insurance Company of New York

National Can Corporation
National Westminster Bank USA
Nordson Corporation
North American Philips Corporation
The Northern Trust Company
Northwest Industries, Inc.

Oshkosh Truck Corporation
Owens-Illinois, Inc.

PPG Industries, Inc.
PACCAR Inc.
Pacific Gas and Electric Company
Pacific Resources Inc.
The Parker Pen Company
The Peoples Gas Light & Coke Company
PepsiCo, Inc.
The Pillsbury Company
Polaroid Corporation
Prime Computer, Inc.
Public Service Electric and Gas Company (Newark, New Jersey)

The Quaker Oats Company

RCA Corporation
Ralston Purina Company
Richardson-Vicks, Inc.
Rohm & Haas Company
Rohr Corporation

Salt River Project
Savannah Foods and Industries
G. D. Searle & Co.
Sears, Roebuck and Co.
Security Pacific National Bank
The Seven-Up Company
The Sherwin-Williams Company
Siemens-Allis, Inc.
Signode Corporation
Simpson Timber Company
Smith International Inc.
SmithKline Beckman Corporation
Southern California Edison Company
The Southern Company
Square D Company
Standard Insurance Company
Standard Oil Company (Indiana)
State Farm Insurance Companies
Sterling Drug Inc.
Suburban Bancorporation
Sun Company, Inc.
Sundstrand Corporation

TRW Inc.
Tandem Computers Incorporated
Tenneco Inc.
Texas Instruments Incorporated
Transamerica Corporation
The Travelers Insurance Companies

United Nuclear Corporation

Underwriters Laboratories, Inc.
Union Camp Corporation
Union Carbide Corporation
United States Gypsum Company
Urban Investment and Development Company
Utah International, Inc.

Vulcan Materials Company

Washington National Insurance Company
Wausau Insurance Companies
Weyerhaeuser Company
Wisconsin Electric Power Company
Wisconsin Public Service Corporation
William Wrigley Jr. Company

Zenith Electronics Corporation

Hewitt Associates

An international firm of consultants and actuaries in compensation, employee benefits, communication, and related financial and human resource functions

United States
Professional Centers

100 Half Day Road
Lincolnshire, Illinois 60015
(312) 295-5000

4590 MacArthur Boulevard
Newport Beach, California 92660
(714) 955-1800

40 Highland Avenue
Rowayton, Connecticut 06853
(203) 852-1100

25231 Grogan's Mill Road
The Woodlands, Texas 77380
(713) 363-0456

United States
Regional Consulting Offices

Atlanta
Boston
Chicago
Dallas
Dayton
Denver
Detroit
Houston
Los Angeles
Milwaukee
Minneapolis
New York
Phoenix
St. Louis
San Francisco
Tampa

International
Centres and Offices

160 Bloor Street East
Toronto, Ontario M4W 1B9
CANADA
(416) 961-5090

3, The Old School House
George Street
Hemel Hempstead
Hertfordshire HP2 5HJ
ENGLAND
(44) (442) 216611

Management
Compensation Services

7579 East Main Street
Scottsdale, Arizona 85251
(602) 994-1373
(A wholly-owned, independently operated division of Hewitt Associates)

©1985, Hewitt Associates

IEEE WASHINGTON OFFICE
THE INSTITUTE OF ELECTRICAL AND ELECTRONICS ENGINEERS, INC.
1111 19th STREET, N.W. WASHINGTON, DC 20036-3690, U.S.A. TELEPHONE (202) 785-0017

Contact: W. Thomas Suttle
202/785-0017

STATEMENT SUPPORTING PENSION REFORM

SUBMITTED TO THE
SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS
COMMITTEE ON EDUCATION AND LABOR
U.S. HOUSE OF REPRESENTATIVES
BY
THE INSTITUTE OF ELECTRICAL AND ELECTRONICS ENGINEERS, INC. (IEEE)
THE AMERICAN INSTITUTE OF CHEMISTS (AIC)
THE AMERICAN SOCIETY OF CIVIL ENGINEERS (ASCE)
AND
THE AMERICAN SOCIETY OF MECHANICAL ENGINEERS (ASME)

April - 1985

The IEEE, AIC, ASCE, and ASME commend the initiative of the Chairman in holding hearings on employee benefits and the need for a national retirement income policy. In order to address ourselves to these broad issues in a useful manner, our statement is limited to the issues of vesting, integration, portability, and defined contribution pension plans vs. defined benefit pension plans.

This statement represents the views of the memberships of IEEE, AIC, ASCE, and ASME who feel that existing pension laws are inequitable and unfair to engineers, scientists, and similar mobile individuals. The IEEE, which celebrated its centennial anniversary 1984, is the world's largest technical professional society, representing over 250,000 members. The AIC is a society of 5,000 professional chemists founded in 1923 which includes three members of the House of Representatives among its distinguished Fellows. ASCE is the oldest technical professional society in the United States, representing 100,000 members. ASME is a non-profit, educational, scientific, charitable society, founded over 100 years ago, whose membership of Mechanical Engineers and students exceeds 110,000. Our societies, who collectively represent almost a half million engineers and scientists, are an established and highly respected part of the nation's scientific and engineering infrastructure.

VESTING

The essence of our problem is embodied in the conflict between common vesting requirements and existing work patterns of our memberships, and other similarly mobile workers. The majority of our members are employees of corporations and are participants in employer pension plans that utilize ten (10) year cliff vesting; however, the average time spent with a single employer is considerally less than ten (10) years. Mr. Chairman, we assure you that we are not "flighty people". It is simply a fact of modern life that technical professionals are frequently hired to solve specific technical problems; and, when those problems are solved, we move on. That is in the interest of the country, its productivity, its technological advancement, and its economic growth.

But, the price we pay for the fluid employment pattern in our profession is repeated pension forfeiture. Indeed, many of our members change employers again and again, forfeiting pension after pension, and thus find it difficult to become vested in an employer pension plan. This scenario is a fact for our memberships and unfortunately is even more of an acute problem for workers that are faced with greater mobility than engineering and scientific professionals -- e.g. women.

Therefore, Mr. Chairman, we recommend that ERISA vesting requirements be modified to require full vesting after an employee has completed one year of service, with credit being retroactive to the commencement of employment.

SOCIAL SECURITY INTEGRATION

The effects of integration of social security benefits with those provided by an employer-sponsored pension plan are confusing and difficult for most pension participants to understand. In many cases, an integrated plan may assure that lower paid workers receive little or nothing from their employer pension plan; however, this knowledge and understanding is generally discovered by the employee only when it is too late for remedial action.

It is our position that the integration of government and private plan benefits:

(1) invariably reduces the benefit provided by the private plan;

(2) effectively provides a disproportionate loss of private pension benefits to lower paid employees and a concomitant gain of private plan benefits to highly paid individuals; and,

(3) adds a substantial degree of complexity to pension plans, which mitigates against the clear understanding of plans by plan participants.

Therefore, we oppose integration of private and government benefits.

PORTABILITY OF VESTED PENSION BENEFITS

As mentioned in previous paragraphs, our members often forfeit pension benefits because of lack of vesting; however, on those rare occasions where they do become vested, an additional complication arises from the characteristic mobility. In the situation where an employee does manage to vest, the benefit is often exceedingly small unless the employment period is quite lengthy (e.g. 30 years). A mobile employee who may have been fortunate enough to vest in several pension plans during the course of a career finds that these vested benefits are individually worth very little, and are reposited with a multitude of different pension plans. Pension portability would allow these fortunate mobile employees to take their vested benefits with them as they move from employer to employer, thus giving them the benefit of one repository for these increments of vested benefits. This in turn would allow the mobile individual to accrue these vested retirement benefits in much the same manner as an employee who is not mobile and thus accrues vested benefits in only one employer's plan. This type of single repository would permit the employees to benefit from the larger accumulation of retirement monies and subsequent benefits of interest compounding over the span of a career. However, there may well be cases in which an employee may wish for the vested benefits to remain with the employer's pension plan, and this should be allowed.

Therefore, we support portability for all vested pension benefits, at the option of the employee.

DEFINED CONTRIBUTION PENSION PLANS

A basic objective of pension benefits is to provide an income sufficient to maintain a reasonable standard of living after an individual retires. Unfortunately, for mobile employees like engineers, this objective is often not met because of the basic nature of defined benefit pension plans. Under these plans, benefits are fixed when employees separate from their employers. The effects of inflation are to reduce the value of benefits over time. Under the system of Defined Contributions, however, portability is a realistic goal through those penson plans with early participation and early vesting. In addition, an individual's benefit would not be frozen but would be commensurate with the plan investment return and would grow over the individual's career. Indeed, there are advantages to both the employee and the employer:

For the employer (simplicity):

* there is no need to designate a normal retirement age, and no actuarial computations are required for active employees, thereby resulting in a small expense saving;
* pension costs are always fully funded, and future costs do not need to be estimated; and,
* the plans are not subject to termination insurance, and there is no contingent liability if the plan should terminate.

For the employee (flexibility and possible portability):

* the participant can watch the account grow, and can, at any time, calculate its current value; additionally, unlike the defined benefit plan, the defined contribution plan does not have the risk of forfeiture;

- the participant can usually choose from a range of options on how to invest the account;
- the account fund continues to grow, even after the participant's employment terminates; and,
- the entire account balance is available as a death benefit.

Therefore, we support legislation that would encourage new industries to offer defined contribution pension plans; in the case of existing defined benefit pension plans, we would encourage employers to start to make available defined contribution plans to new and existing employees without any loss of existing benefits deriving from defined benefit plans.

SUMMARY OF POSITIONS

Mr. Chairman, we recognize and commend actions taken in recent years by the Congress to assist individuals to save for their retirement. The expansion of IRA availability to all working individuals was a major step forward in encouraging people to provide for their own retirment through investment in these tax-deferred savings vehicles; however, we feel that there is much more that needs to be done to bring equity into the pension/retirement system. Thus, based upon the philosophies espoused in the foregoing pages, the IEEE, AIC, ASCE and ASME ask that the Subcommittee support legislation that would:

(1) Mandate full vesting after one year of employment, with credit being retroactive to the commencement of employment.

(2) Eliminate integration of social security with private pension benefits.

(3) Provide for portability of vested pension benefits, at the option of the employee; and,

(4) Encourage new employers to offer defined contribution plans, and encourage existing employers to offer new and existing employees the option of the defined contribution plan without any loss of existing benefits deriving from defined benefit plans.

Mr. Chairman, this concludes our testimony on behalf of the IEEE, AIC, ASCE, and ASME. We look forward to working with you, your colleagues and staff on these issues of concern to our memberships.

NEWS RELEASE

INVESTMENT
COMPANY
INSTITUTE
1600 M Street N.W.
Washington, D.C. 20036
202 293-7700

FOR RELEASE 10 AM, EST
FEBRUARY 28, 1985

CONTACT: Sue Duncan

IRAs Add Billions to New Savings, But Potential Still Untapped

WASHINGTON, D.C., February 28 -- Contributions to Individual Retirement Accounts (IRAs) during the 1983 tax year added $10 billion to new U.S. savings--$10 billion from current earnings that otherwise would have been spent. Although 1984 IRA contributions cannot be tallied until April 15, if these trends continue, at least as much will be added again.

By late last year, only three years after IRAs were liberalized, some 23 million households had opened a retirement account. Nearly two-thirds of these had household incomes under $40,000 per year. Thus, the IRA program is already helping a broad spectrum of the American public achieve their retirement goals. Millions more would take advantage of this program if Congress would expand the spousal IRA, permit additional nondeductible contributions, or allow limited access to the account.

These findings from a report released today by the Investment Company Institute, the national association of mutual funds, are among several drawn from a new survey designed to probe not only how Americans have responded to IRAs, but also how they might react to additional legislative changes.

Based on data collected by Market Facts, Inc. and analyzed by the Institute, the survey "confirms the astounding success of the IRA program," says Institute President David Silver. "In addition to providing millions of Americans with the opportunity to plan for retirement, this do-it-yourself program allows each IRA owner to choose from among the full range of savings/investment options available, ensuring an undistorted flow of stable, long-term capital to finance industry, commerce, and agriculture."

IRA assets climbed from $26 billion at the start of 1982, when nearly everyone with earned income became eligible for these plans, to $132 billion at the end of 1984.

"With their 1985 contributions," notes Silver, "those who have put away the maximum $2,000 each year since 1982 will bring their IRA balances to $8,000, before any earnings. And with that much accumulated, IRA owners should begin to realize their accounts are much more than just year-end tax deductions. They're long-term investments. The question of how and where to get the most for their money should weigh more heavily."

Mutual-fund IRAs, now accounting for $16 billion, have outpaced the growth of the market as a whole. Because of their long-term investment performance record, mutual funds and IRAs make an excellent match. Stock funds, for instance, have averaged an annual return of more than 15 percent during the past decade, compared to 7.3 percent for consumer prices.

But despite the rapid growth of IRA assets, about 3 out of 5 U.S. households in groups most likely to open an IRA (heads of households under age 65, household incomes $15,000 or more) have not yet done so. The Institute, which helped spearhead the drive to liberalize IRAs, set out to study how the IRA program could be improved, so that more people would participate. The resulting survey identifies three barriers to IRA investment. From the survey responses, an attempt was made to estimate how individuals might respond if these barriers were removed. Here's what could happen if Congress made the following three modifications.

1. **Equal Footing for Spousal IRA.** A married couple with both spouses working outside the home can set up two IRAs and contribute a combined $4,000 per year. However, if one spouse is nonemployed, the couple can set up a regular and a "spousal" IRA, but is limited to only a combined $2,250 per year. Many individuals eligible for a spousal account feel the amount is not large enough to amass a sizeable retirement nest-egg. If the spousal ceiling were raised to $2,000, the same as for the regular IRA, the Institute estimates that, of those IRA owners eligible for a spousal account, as many as 5 million households might open or expand one, based on projections from survey respondents.

The Treasury Department's tax-reform proposals call the existing IRA limitations "illogical and inequitable as applied to married couples." Treasury has proposed lifting the ceilings on both the spousal and the regular IRA to $2,500, so that a married couple, whether one or both spouses work outside the home, could contribute a maximum $5,000 annually.

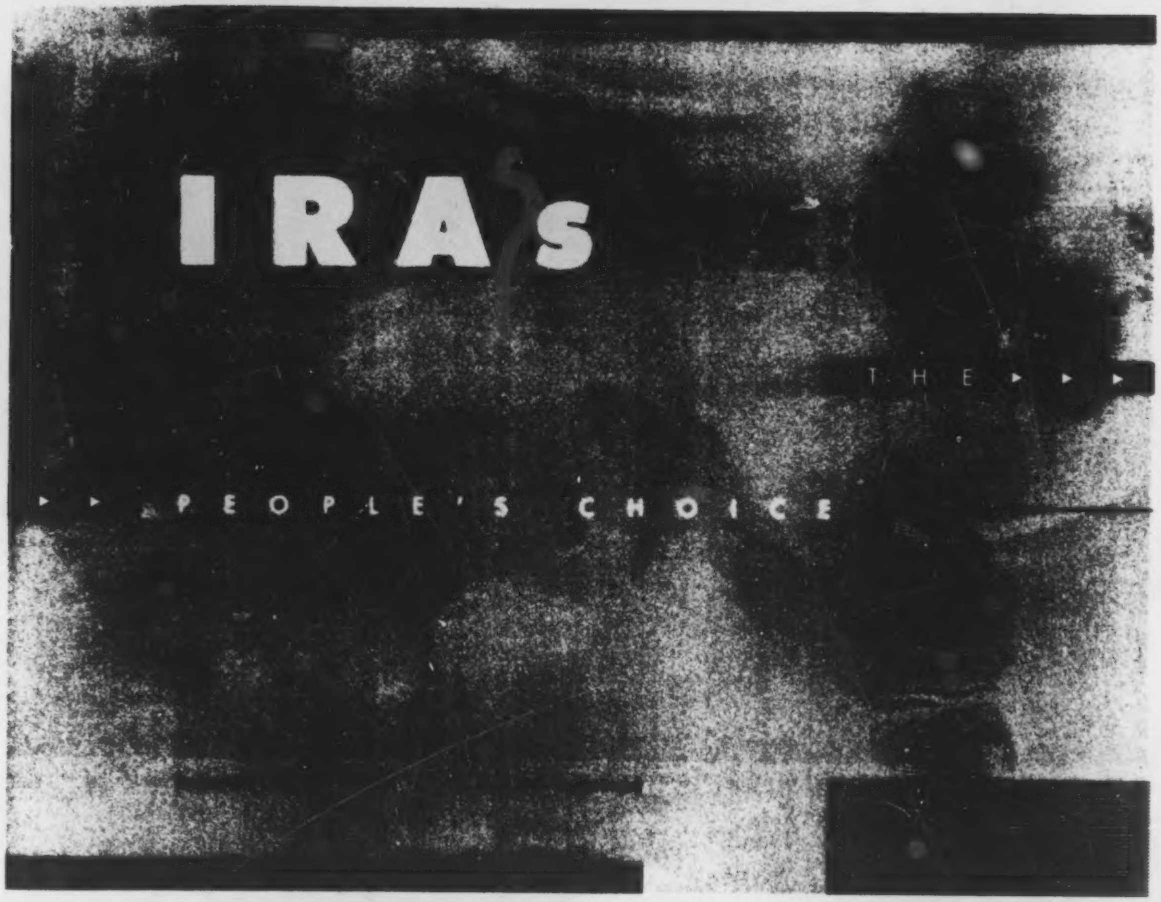
The Senate passed a spousal increase last year and at least ten bills already introduced in this Congress would expand either the regular, the spousal, or both types of IRA. "There's really no excuse for the spousal inequity," says Rep. W. Henson Moore (R-LA), a key Congressional leader in getting IRAs liberalized. "In some ways, the woman working at home needs an individual retirement plan more than anyone else, since she hasn't got the chance to build up a pension or other supplement to Social Security."

2. Additional Nondeductible Contributions. Currently, no more than $2,000 per year can be contributed to an IRA; contributions are tax-deductible and all earnings accumulate tax-deferred until withdrawal. The survey sought to elicit information about the effect of permitting additional nondeductible contributions with tax-deferred earnings. Based on the survey responses, the Institute estimates that, if these contributions were allowed, about 6 million households would be "highly likely" to make them. As might be expected, the older the respondent, the more likely he or she would make such a contribution. Many older Americans (ages 50 to 65) feel the current limits do not allow sufficient funds to build in the time remaining before their retirement.

3. Limited Access Without Penalty. One commonly mentioned obstacle to opening an IRA is the lack of access. An IRA owner who withdraws funds for any reason before the age of 59 1/2 incurs a 10 percent tax penalty (in addition to normal taxes). If people were permitted to withdraw IRA funds without penalty for the purchase of a home, education expenses, or financial emergencies, as many as 19 million households (with heads of households under age 65, household incomes of $15,000 or higher) would be more likely to open an IRA, based on projections from survey respondents. Younger respondents (under age 40), presumably with major expenditures still ahead of them, were particularly inclined to do so.

Data for this study were obtained from a survey of 5,000 households conducted late last year by Market Facts, Inc., a major market research firm. The questionnaire used was jointly developed by the Institute's Research Department and Market Facts, with the results tabulated by Market Facts and analyzed by the Institute in its report, IRAs: The People's Choice. About 3,500 or 70 percent of those who received the questionnaire responded; the income and age distributions of the sample closely match those of the U.S. household population.

Note to Editors: For copies of the survey report, IRAs: The People's Choice, write to the Investment Company Institute, 1600 M Street, N.W., Washington, D.C. 20036.



IRAs

THE PEOPLE'S CHOICE

INDEX OF CHARTS

2. THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974
4. IRA ASSETS OUTSTANDING
6. MUTUAL FUND IRA ACTIVITY
8. STRUCTURE OF THE IRA MARKET
10. AWARE THAT WORKING PERSON CAN CONTRIBUTE UP TO $2,000 PER YEAR TO AN IRA ACCOUNT
12. REASONS FOR OPENING AN IRA
14. REASONS CONSIDERED EXTREMELY IMPORTANT FOR OPENING AN IRA - BY HOUSEHOLD INCOME
16. PERCENTAGE OF HOUSEHOLDS OWNING IRAS AND POTENTIAL MARKET - BY HOUSEHOLD INCOME
18. PERCENTAGE OF HOUSEHOLDS OWNING IRAS - BY AGE
20. OWNERSHIP OF DIFFERENT TYPES OF IRAS - BY TYPE IRA OWNED
22. IRA OWNERS' KNOWLEDGE OF IRA FEATURES
24. DIVERSIFICATION OF IRAS
26. CHARACTERISTICS OF IRA OWNERS - BY IRA FUNDING VEHICLE
28. KEY FACTORS IN SELECTION OF IRA FUNDING VEHICLE
30. CHARACTERISTICS OF IRA OWNERS AND NON-OWNERS
32. REASONS FOR NOT OPENING AN IRA
34. EVENTS VITAL TO DECISION TO OPEN AN IRA
38. IMPACT OF EARLY WITHDRAWAL PENALTIES ON THE WILLINGNESS OF NON-OWNERS TO OPEN AN IRA
40. LIKELIHOOD OWNERS WOULD CONTRIBUTE LESS TO IRAS IF WITHDRAWAL PENALTY INCREASED
42. LIKELIHOOD OWNERS WOULD MAKE ADDITIONAL CONTRIBUTION TO IRA IF NOT TAX DEDUCTIBLE, BUT EARNINGS TAX FREE
44. REACTION OF IRA OWNERS TO EXPANSION OF DEDUCTIBLE CONTRIBUTIONS FOR NON-WORKING SPOUSES
46. SOURCE OF MONEY FOR AN IRA INVESTMENT
48. SAVINGS OUT OF CURRENT INCOME HAD MONEY NOT BEEN PUT IN AN IRA
50. TYPE OF SAVING SELECTED HAD MONEY NOT BEEN PUT IN AN IRA
52. IRA ASSETS INVESTED IN MUTUAL FUNDS
54. STOCKS, BILLS, AND INFLATION
56. MEDIAN EXPECTED ANNUAL RATE OF RETURN
58. FAMILIARITY WITH MUTUAL FUNDS - BY IRA OWNERSHIP
60. TOTAL ASSETS AND TOTAL NUMBER OF FUNDS - ALL TYPES OF FUNDS

INTRODUCTION

This report is designed to track the growth of activity in Individual Retirement Accounts (IRAs); review the structure of the market; identify the characteristics and attitudes of IRA owners and non-owners; assess their reaction to possible changes in the existing IRA law; and consider the impact of IRAs on saving.

This study presents a considerable body of new information about both the IRA market and the financial needs of consumers, particularly as they relate to retirement. It is yet another step in the efforts of the mutual fund industry to understand these needs and effectively respond to them. That we have achieved some success in this regard is evident in our ability to obtain an expanding share of the IRA market.

Most of the data compiled in this report were obtained from a survey of households conducted late last year. The questionnaire used to gather the data was developed by the Institute's research staff, with help from Market Facts, Inc., a major market research firm. Market Facts conducted the survey by mailing questionnaires to a representative group of its 200,000 panel members.

Approximately 5,000 questionnaires were mailed and 3,487 were returned. Of this latter number, 965 were IRA owners and 2,522 were non-owners. The overall response rate was a high 70.0 percent and the income and age distributions of the sample closely match those of the U. S. household population. Finally, Market Facts tabulated the survey data, while the Institute's research staff assumed responsibility for the analysis and the preparation of this report.

IRAS: THE START OF SOMETHING BIG

In 1974, Congress passed the Employee Retirement Income Security Act. This landmark law improved the private retirement plan system in many ways. Of all of the provisions included in this Act, however, one of the most important was the establishment of the Individual Retirement Account (IRA). Stated in the simplest terms, it represented a beginning toward helping tens of millions of people to grasp firmer control over their financial future by permitting them to establish their own retirement programs.

Commencing in 1975, any individual earner under age 70-1/2 who was not an active participant in a qualified retirement program could open an IRA in a mutual fund, insurance company, or other type of financial institution. Individuals were permitted to contribute up to 15 percent of their compensation each year up to an annual limit of $1,500. They were allowed to open more than one account as long as each year's IRA contribution did not exceed the legal limit. Individuals were also permitted to transfer existing IRA funds from one financial institution to another without penalty, if they chose to do so.

The amounts that individuals contribute to an IRA account are declared to be 100 percent tax deductible each year. These contributions go into a tax sheltered program so that all dividends, interest, and capital gains are allowed to compound year after year and be reinvested completely tax free. Distributions from the IRA to the retired participant are taxed when received. Withdrawals from the account prior to age 59-1/2 carry a penalty.

The Employee Retirement Income Security Act of 1974

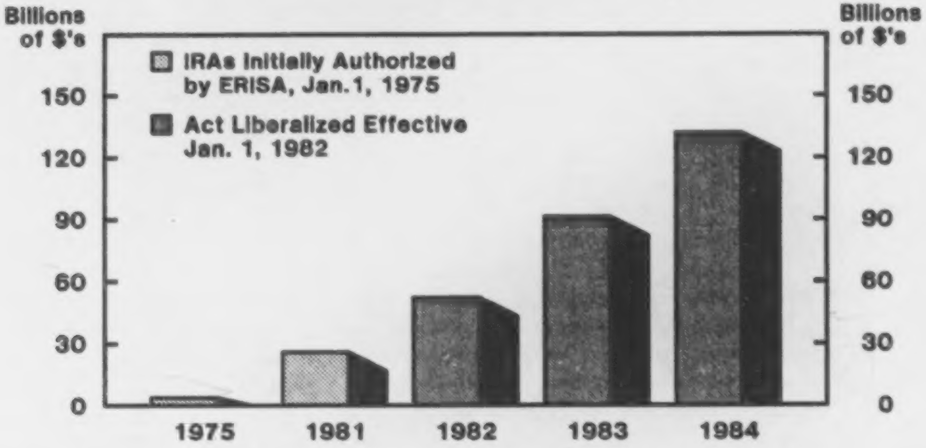
LIBERALIZATION IN THE IRA LAW PRODUCED SUBSTANTIAL GROWTH

The public's initial response to IRAs was significant, but not overwhelming. From the beginning of 1975 to the end of 1981, the number of dollars invested in IRAs rose from zero to $26.0 billion. During that period, it became increasingly clear to the public and legislators alike that inflation was not only undercutting people's ability to save, but was also eroding the purchasing power of retirement dollars available from both social security and private retirement plans. The need for individuals to supplement these plans through their own savings initiatives were greater than ever.

Consequently, IRAs were liberalized beginning January 1, 1982. The prohibition against use of IRAs by persons covered by a qualified plan was abandoned so that virtually all employed individuals became eligible. In addition, the limitation on deductible contributions was raised from $1,500 to the lesser of $2,000 or 100 percent of compensation and the spousal IRA of up to $250 a year was authorized. In the first year after liberalization, IRA assets rose $26 billion -- as much as had been accumulated in the preceding seven years. At the end of 1984, IRA assets totaled $132 billion, a sum which clearly indicates the public's acceptance of "do-it-yourself" retirement programs.

As we shall see, IRAs are helping a broad spectrum of the American public to achieve their retirement goals -- help that is especially needed by families with low to moderate incomes. In addition, IRAs have increased the total volume of saving in the U. S. and channeled a larger portion of such saving into long-term investments. Additional legislative adjustments designed to further liberalize IRA restrictions would provide increased public benefits.

IRA ASSETS OUTSTANDING, END OF YEAR



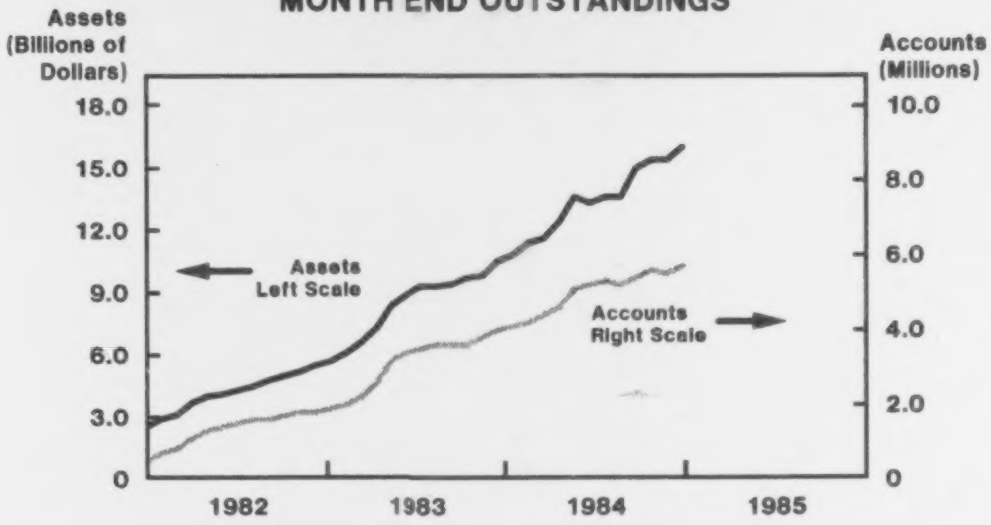
MUTUAL FUNDS AND IRAS: AN EXCELLENT MATCH

IRA assets and accounts of mutual fund organizations have likewise grown rapidly. Between the beginning of 1982 and the end of 1984, the number of mutual fund IRA accounts has risen from 500,000 to 6.0 million and mutual fund IRA assets have increased from $2.6 billion to about $16.0 billion.

Mutual funds have expanded sharply because they make an excellent match with IRAs. They offer a variety of choices -- stock, bond, income, and money market funds -- to satisfy the financial needs of a wide range of investors, from the most conservative to the most aggressive. Funds are also uniquely positioned to offer the IRA owner flexibility. By using the exchange privilege within a family of mutual funds, the investor can shift investments from one type of fund to another in response to changes in personal finances or the economic and financial outlook.

The diversification offered by mutual funds allows the IRA owner to limit investment risk. Most funds invest across a wide range of industries and companies, so the IRA investment is not concentrated in just one or two securities. In addition, professional management insures that experts will continuously monitor the investments in accordance with the fund's objectives. This relieves the IRA owner of worrying about such details.

Finally, stock mutual funds offer superior investment performance, particularly over the long-term. Bond and income funds, however, may be more compatible with the needs of other individuals. For more safety-minded IRA investors, money market funds offer just about the highest short-term rates available at minimal risk.



MUTUAL FUND IRA ACTIVITY

MONTH END OUTSTANDINGS

GROWTH OF MUTUAL FUND IRAS OUTPACES THE MARKET

The rapid growth of mutual fund IRAs since the beginning of 1982 has enabled the mutual fund industry to increase its share of the total IRA market. Commercial banks, credit unions, and self-directed plans available through brokerage firms have also increased their market shares at the expense of savings and loan associations, mutual savings banks, and insurance companies.

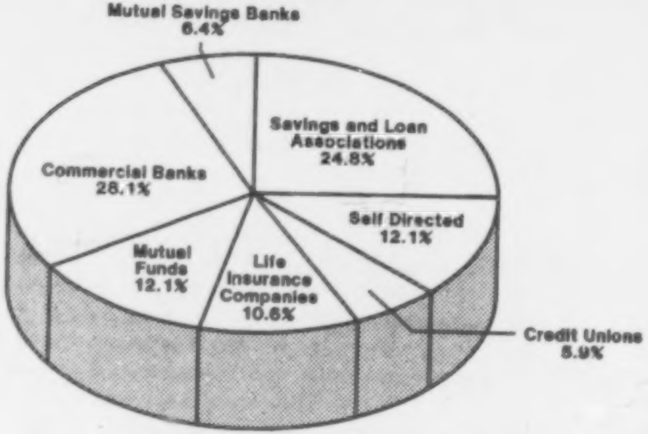
Mutual fund IRA assets are now 6-1/2 times their level at the beginning of 1982, while total IRA assets are 5 times their earlier level. The greater rate of growth experienced by mutual funds has resulted in an increased share of the market -- from 9.9 percent prior to the liberalization of IRAs to 12.1 percent at year-end 1984.

At the end of 1981, depository institutions (commercial banks, mutual savings banks, and savings and loan associations), which have traditionally dominated this market, accounted for over three-fourths of all IRA assets. They now represent about 60 percent of the market. This drop in market share is attributable to savings and loan associations and mutual savings banks whose actual balances have increased but at a slower rate than the total. Commercial banks have increased their market share -- from 22.5 percent to 28.1 percent.

Credit unions, which had a nominal market share before liberalization, now account for nearly 6 percent of the total. Self-directed IRA accounts at brokerage firms, for which earlier estimates are not available, currently represent about 12 percent of all IRA assets. Market share for insurance products has dropped from 12.7 percent to 10.6 percent.

STRUCTURE OF THE IRA MARKET

DECEMBER, 1984



$132 Billion

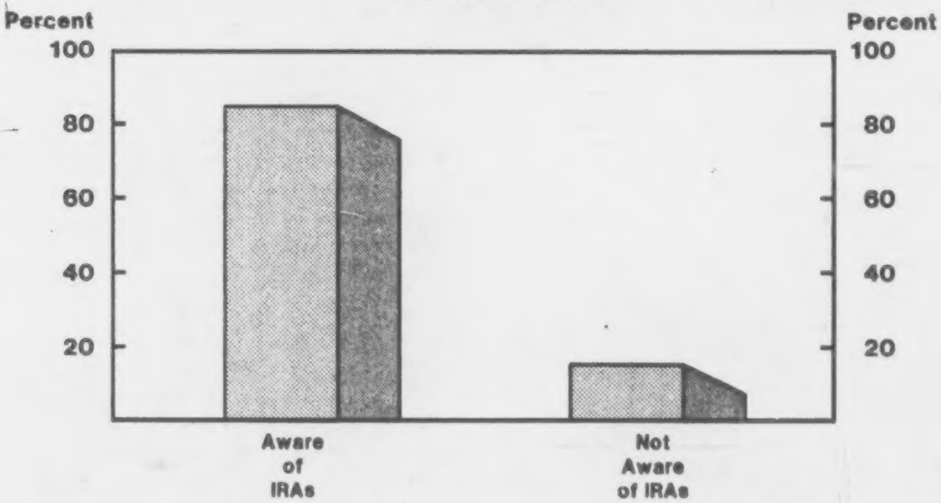
MOST HOUSEHOLDS IN THE U. S. ARE AWARE OF IRAS

The flip-side of growth in IRA assets and accounts is an enormous increase in household ownership of IRAs. One of the first steps in the transition from non-owner to owner is awareness that all working persons are able to contribute up to $2,000 a year to an IRA. In view of the promotion of IRAs by financial institutions and the publicity showered on them by the media, it is not surprising that about 85 percent of all households are aware of IRAs.

While only 15 percent of all respondents were not aware of IRAs, lack of awareness was greater among younger people and those with lower incomes. Thirty percent of those with incomes of $15,000 a year or less -- almost 9.5 million individuals -- are not aware of IRAs. One might conclude that these households are not prime prospects for IRA's and, in the short-term, this may be true. Many of them, however, could be young people just entering the work force who, a few years from now, may be likely IRA consumers.

In fact, when households are classified by age, nearly 26 percent of those under age 30 are not aware of the availability of IRAs while 15 percent of those in their thirties are not aware. This translates to nearly 4 million households in the youngest age group and 2.8 million households in the 30-40 year range. The highest levels of awareness occur in households with incomes over $30,000 a year and ages ranging between 40 and 65 years. These groups also report the highest levels of IRA ownership.

AWARE THAT WORKING PERSONS CAN CONTRIBUTE UP TO $2000 PER YEAR TO AN IRA



SAVING ON TAXES AND SUPPLEMENTING RETIREMENT INCOME ARE THE PRIMARY REASONS FOR OPENING AN IRA

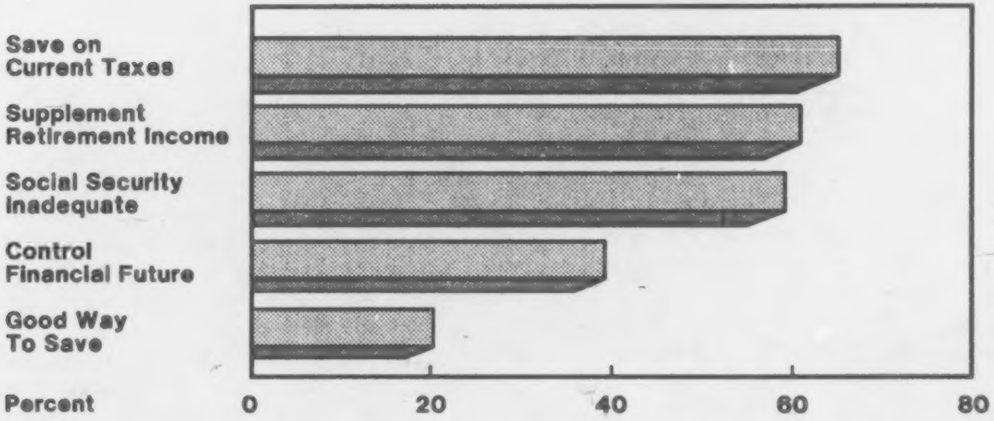
Saving on current taxes was the most frequently cited reason for opening an IRA. Of almost equal concern was the desire to supplement retirement income and the feeling that social security would not provide an adequate retirement income. Nearly two-thirds of all owners cited tax savings as an extremely important reason for opening their IRA. About 3 out of 5 indicated that supplementing retirement income and the inadequacy of social security were extremely important motivators for them. The importance of the reasons vary by such factors as age and income.

Data from the New Beneficiary Survey conducted under the direction of the Social Security Administration indicate that, for recently retired couples, the median monthly social security benefits received in 1982 was $646. Just over half of these couples also received retirement benefits from employer sponsored plans, the median monthly amount being $490. Asset income, received by a substantial portion of the couples, contributed the least to monthly incomes -- the median being $180. Comparable figures for unmarried individuals were lower. The median monthly retirement income received by married couples totaled $1,070.

Social security is the largest component of retirement income, but the median annual amount received by married couples is only $7,800. Clearly the ownership of an IRA would increase the amount of retirement income received from assets of the individual and would add to the pool of available funds. Such additional income would be especially valuable for those not receiving income from an employer sponsored retirement plan.

REASONS FOR OPENING AN IRA

PERCENT SAYING "EXTREMELY IMPORTANT"



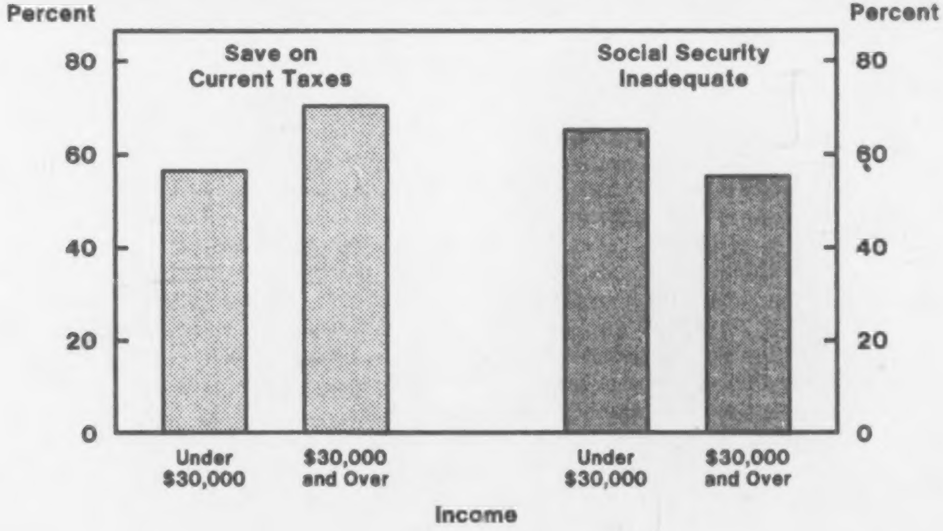
REASONS FOR OPENING AN IRA VARY BY INCOME AND OTHER CHARACTERISTICS

As noted earlier, the importance of various reasons for opening an IRA are related to the household income and age levels of the owner. While saving on current taxes was the most frequently cited reason for opening an IRA, it was far more important to those earning $30,000 per year or more. Those earning below that amount recognize the tax advantage of an IRA, but they placed greater emphasis on the need to supplement their retirement income and they expressed greater concern about the inadequacies of social security. These concerns are well founded. The New Beneficiary Study mentioned earlier determined that, at the lower to middle income levels, social security is the major component of total retirement income. Presumably many in moderate to higher household income brackets have other assets accumulated toward retirement and have more substantial employer sponsored retirement plans than those in the lower income brackets.

Age also influences the reasons for opening an IRA. Those in their thirties place more emphasis on retirement income and concern about social security. Owners in their forties cited these reasons with the same frequency as saving on taxes. Tax savings was cited most often by those 50 years of age and over. For this group, the need to supplement retirement income declined as they approached or passed retirement age. These differences by age probably reflect the income brackets of the household.

Households with incomes under $30,000 a year are more likely not to have worked with their current employer for an extended period of time and they are not as likely to be vested participants in an employer sponsored retirement plan. Thus their need for an IRA is greater than that of other groups.

REASONS CONSIDERED EXTREMELY IMPORTANT FOR OPENING AN IRA BY HOUSEHOLD INCOME



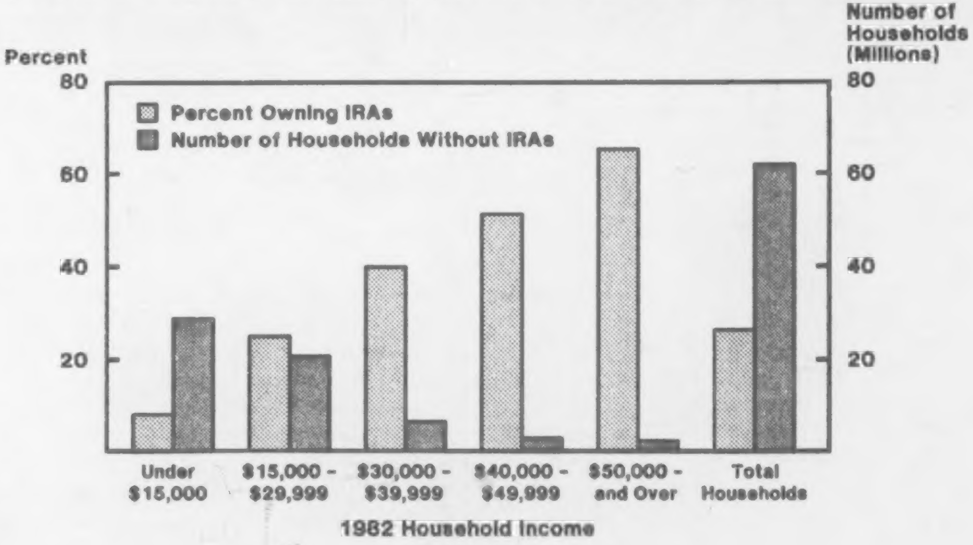
INCOME IS A MAJOR FACTOR IN IRA OWNERSHIP

By November 1984, about 23 million households, or 28 percent of all households, owned an IRA. Owners span a wide range of income levels; in fact, nearly two-thirds have household incomes of less than $40,000 per year. Clearly IRAs have benefited people at all income levels.

As expected, ownership occurs with greater frequency in the higher income brackets. About two-thirds of the households with incomes of $50,000 or more have an IRA. Half of those households with earnings in the $40,000 range have one. This participation rate continues to decline for lower income groups. Even so, one-fourth of all households with incomes between $15,000 and $30,000 a year own IRAs, while only 8 percent of those with incomes below $15,000 own one. Having dollars available to fund an IRA is obviously a critical consideration.

About 61 million households have no IRA. Of this number 28 million have annual incomes below $15,000 a year and 20 million have incomes between $15,000 and $30,000. About 12 million households have incomes greater than $30,000 a year but they still have not opened an IRA. Two-thirds of these higher income households are in the prime age groups for buying an IRA -- 30 to 60 years of age. This age and income group is also highly aware of IRAs. Some of these promising prospects, however, may not have opened an IRA because they feel they already have an adequate retirement plan or have other savings objectives.

PERCENTAGE OF HOUSEHOLDS OWNING IRAs AND POTENTIAL MARKET BY HOUSEHOLD INCOME



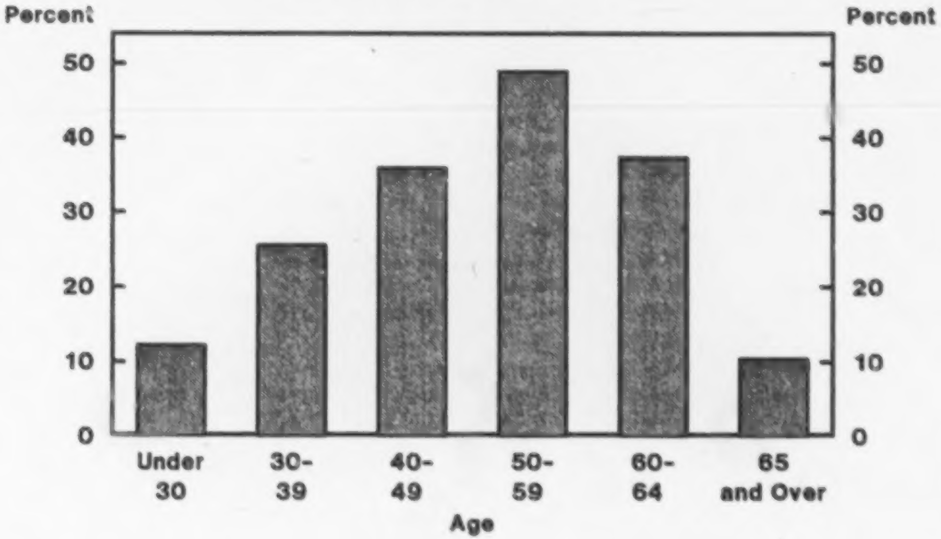
AGE IS ALSO A SIGNIFICANT DETERMINANT OF IRA OWNERSHIP

Ownership of IRAs differs by age bracket of the household. Ownership is highest for those in their fifties. Nearly half of all households in this age group have an IRA. Over a third of the households in their forties and those in their early sixties have one. While one-fourth of those in their thirties have an IRA, only 12 percent of those under 30 have one. Again, about one-fourth of this youngest group is not aware of IRAs. As expected, ownership is least frequent in households over the age of 64.

Thirteen million households under the age of 30 and a similar number in their 30s do not own an IRA. Three-fourths of these households have incomes under $30,000 a year. In addition to the income factor, younger people are likely to view retirement as a long way off and they may not yet feel the need to begin accumulating funds for this purpose. People in these age groups tend to be under great pressure to spend, not save. This follows because many of them are beginning their families, purchasing homes, and so forth.

About 15 million households in their forties and fifties do not own an IRA. Two-thirds of these have incomes below $30,000. Four million households between the ages of 60 and 64 years do not own an IRA. It is reasonable to assume that, if they have not yet retired, this group feels they are too close to retirement to make establishing an IRA worthwhile. One-fifth of all non-owners are 65 years of age or older and many have presumably retired.

PERCENTAGE OF HOUSEHOLDS OWNING IRAs BY AGE



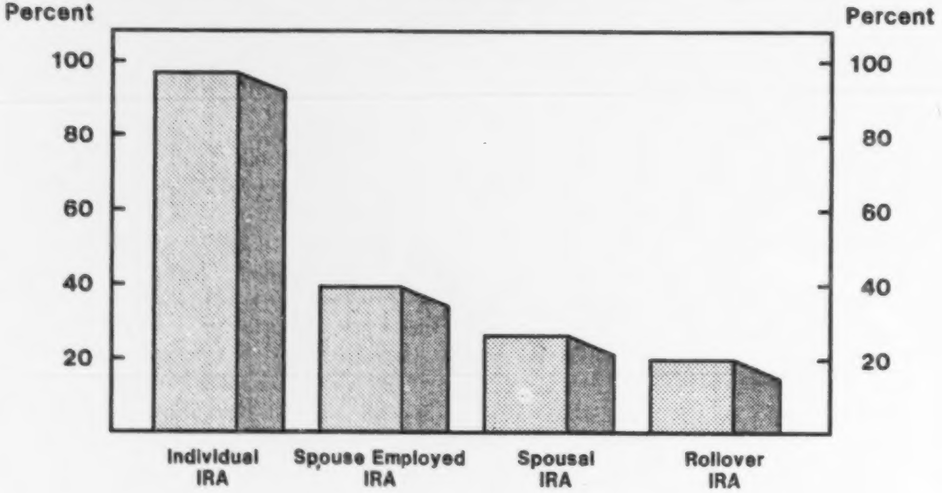
HOUSEHOLDS OWN A VARIETY OF DIFFERENT TYPES OF IRAS

In preceding sections of this report, we have reviewed the characteristics of IRA owners. The data in the accompanying chart, however, provides a somewhat different perspective -- it shows how the four major types of IRAs are distributed among IRA owners. Not surprisingly, almost 100 percent of all owners report having an individual IRA. Nearly 40 percent indicate their employed spouse owns an IRA, while about 26 percent own a spousal IRA. Only about 20 percent own a rollover IRA.

The median balances held in the various types of accounts in the latter part of 1984 also vary significantly. The median outstanding balances in individual and spouse-employed accounts were $4,460 and $4,669, respectively. The median balance in a spousal IRA ($965) is much lower. Most owners of these types of IRAs make their contributions between January and April of the calendar year, either for the preceding tax year or the current one. As we shall see later, many IRA owners contribute close to the maximum allowable limit. As expected, the median balance in a rollover IRA is significantly higher ($9,063) than the amounts in other types of accounts. The source of funds in the rollover account is previously existing employer sponsored retirement plans which, upon termination of employment, the individual "rolls over" to an individual IRA.

OWNERSHIP OF DIFFERENT TYPES OF IRAs

PERCENT OF IRA OWNERS BY TYPE OWNED



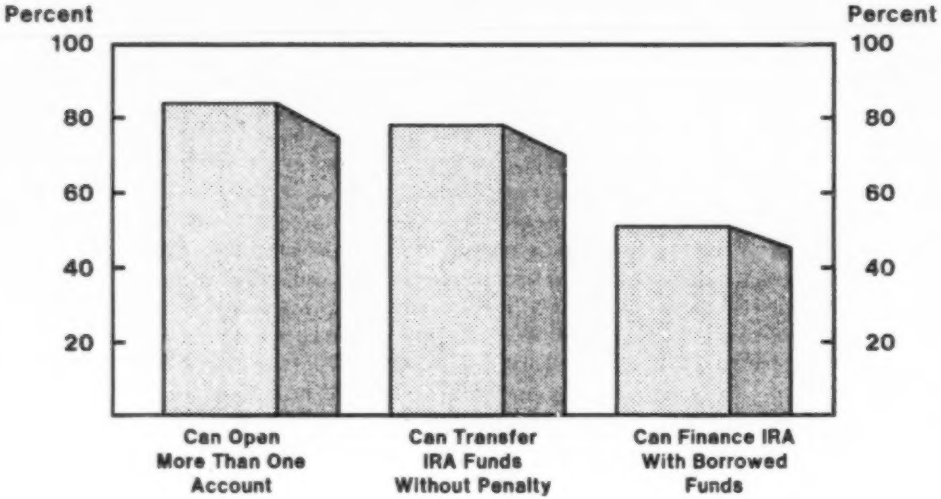
OWNERS HAVE A HIGH AWARENESS OF VARIOUS IRA FEATURES

Most owners have a high level of awareness of three key features designed to give them more flexibility in handling their IRA investments. Many of them know, for example, that they can: (a) Have more than one account; (b) Transfer their accounts; and (c) Borrow to fund their accounts. About 8 in 10 IRA owners, for example, are aware that they can open more than one account as long as each year's IRA contribution doesn't exceed $2,000. A smiliar percentage is also aware that the tax laws permit them to transfer their IRA from one institution to another or from one type of investment to another, without penalty. Respondents with incomes of $40,000 or more, those who are college-educated, and those over age 50, tend to be more aware of each of these two features than respondents who are younger and have lower incomes and less formal education.

Only about 1 in 2 respondents are aware that the tax laws permit them to borrow money to fund an IRA, and to take both the IRA deduction and the deduction for interest paid on the loan. The greatest variation in awareness of this feature is found among groups classified by income. Only about 1 in 3 households with incomes of $15,000 or less are aware of this feature. In contrast, those with incomes of $50,000 or more are aware of the tax savings associated with this feature.

IRA OWNERS' KNOWLEDGE OF IRA FEATURES

PERCENT AWARE OF FEATURES



MOST IRA OWNERS HAVE ONLY ONE IRA ACCOUNT WITH ONE INSTITUTION

In spite of their awareness that they can have more than one IRA account, the majority of IRA owners have not yet taken advantage of that feature. Use of more than one institution to handle the IRA is even less frequent. About two-thirds of the owners of individual and spouse-employed IRAs have only one account while three-fourths of the rollover IRA owners have only one account. The percentage of these owners using only one institution is even higher. For example, less than 1 in 6 of the individual IRA owners use two institutions (either two institutions of the same type or two different types of institutions) and fewer than 1 in 20 use three institutions.

This lack of diversification could be partially due to the size of the balances currently in IRAs. As balances grow, owners may become more inclined to spread the investment over different types of vehicles. Rollover IRAs, even though they are larger, may be concentrated because owners received payment in a lump sum and it may have been easier to reinvest it the same way.

Those who do have multiple accounts and utilize multiple institutions tend to be a bit older (in their fifties), have larger incomes and higher levels of education. Mutual fund owners, and those very familiar with mutual funds, are also more likely to use multiple accounts and institutions. IRA owners using mutual funds and stocks and bonds as their IRA investment have different characteristics and investment preferences than owners using deposit accounts. These differences will be explored in the next few pages.

DIVERSIFICATION OF IRAs

Type of IRA	Number of Accounts			Number of Institutions		
	1	2	3 or More	1	2	3 or More
Individual	66.7%	19.6%	13.4%	81.3%	14.3%	4.3%
Spouse Employed	67.1	20.0	12.1	78.8	13.4	7.0
Spousal	61.4	19.3	17.1	82.9	6.4	8.5
Rollover	77.3	11.4	10.2	83.0	5.7	10.2

MUTUAL FUND IRAS ATTRACT HIGHER-INCOME, BETTER-EDUCATED INDIVIDUALS

Those choosing mutual funds and securities (stocks and bonds) to fund their IRAs have higher incomes than those choosing other investment vehicles. Over 60 percent of these IRA investors have incomes over $40,000 a year compared with 40 percent of those using deposit accounts. In contrast, over one-third of those using deposit accounts for their IRA investment have incomes below $30,000 a year. Only one-fourth of those using mutual funds have incomes below $30,000 and an even smaller percentage of those using stocks and bonds are in that income bracket.

Similarly, those using mutual funds and securities are better educated--nearly 6 in 10 have college degrees or have attended graduate school. In contrast, only about 4 in 10 of those using deposit accounts to fund their IRAs have comparable levels of education.

Age is also a factor in the choice of a funding vehicle. About 2 in 10 of those using deposit accounts are 60 years of age or older, while only 1 in 10 of those using mutual funds or securities are at that age level. Stocks, bonds, and mutual funds seem to have far more appeal to individuals under 50 years of age. They apparently regard their investment as much more long-term than those who are nearing retirement.

CHARACTERISTICS OF IRA OWNERS BY IRA FUNDING VEHICLE

	IRA Funding Vehicle			
Income	**Deposit Accounts**	**Mutual Funds**	**Stocks & Bonds**	**Other**
Under $15,000	6.9%	4.9%	2.7%	11.0%
$15,000 - $29,999	29.8	19.2	13.7	35.5
$30,000 - $39,999	22.6	15.6	19.2	16.3
$40,000 - $49,999	15.9	22.6	24.7	13.4
$50,000 and Over	24.8	37.7	39.7	23.8
Education				
High School or Less	27.8%	18.2%	21.6%	24.3%
Some College	31.0	23.8	20.3	32.3
College Graduate	23.6	28.0	29.7	19.7
Graduate School	17.6	30.0	28.4	23.7
	100.0%	100.0%	100.0%	100.0%

HOUSEHOLDS FUNDING THEIR IRAS WITH MUTUAL FUNDS CITE MAXIMUM POTENTIAL YIELD AS THE MAIN REASON FOR THEIR SELECTION

The accompanying chart shows the factors that were very important to IRA owners in their choice of a funding vehicle. Individuals using mutual funds and securities for their IRA investment most frequently cite maximum potential yield as a very important factor influencing their choice. For those using deposit accounts, minimum risk was the primary consideration. They also placed more emphasis on fixed rates of return, deposit insurance, and low fees. The importance of minimum risk for this group could be due, in part, to their age.

Other studies have shown that people who invest in securities and mutual funds tend to have higher income and education levels than those who do not invest in these types of vehicles. The previous chart showed that this is also true for IRA investors. People who are affluent and well-educated are also apt to be better informed about the "pros" and "cons" of different types of financial products. Because they are better informed, they are more likely to be owners of mutual funds and securities than people in other groups.

The magnitude of the potential return on a particular investment is generally linked to the risks assumed. The more one knows about various investments, the better understanding there will be of the risks involved. These risks can be minimized by diversification (such as mutual funds offer) and investing over a long period of time.

KEY FACTORS IN SELECTION OF IRA FUNDING VEHICLE

Factors Very Important in Selection of Vehicle	IRA Funding Vehicle			
	Deposit Accounts	Mutual Funds	Stocks & Bonds	Other
Fixed Rate of Return	47.3%	22.0%	29.7%	44.4%
Maximum Potential Yield	66.6	77.7	80.3	63.9
Minimum Risk	73.7	44.4	47.1	66.7
Low Fees	52.0	35.2	33.3	52.4
Deposit Insurance	54.7	18.0	29.7	39.6

IRA OWNERS AND NON-OWNERS HAVE DIFFERENT CHARACTERISTICS

The focus in the preceding pages has centered on IRA owners -- who they are, how they regard IRAs, and how they fund them. The next few pages will be devoted to non-owners -- what are their characteristics, why they haven't purchased an IRA, and what would be required to induce them to open an IRA?

As mentioned earlier, 61 million households still do not own an IRA. As this chart shows, 1 in 5 of these non-owners are 65 years of age or older. Another 8 percent are in their early sixties. Clearly, many of these households are not likely to take advantage of an IRA since they are already retired or are so close to retirement that they may not consider it worthwhile. Thirteen million non-owning households are under the age of 30. This group may well be too young to worry about retirement. Non-owners most frequently fall in the younger or older age brackets while owners are more concentrated in the middle age brackets.

Non-owners are also less educated than are owners. Nearly half have never attended college and only 24 percent have graduated from college. Over 40 percent of the owners are college graduates. The income distributions of these two groups are likewise different. Over 40 percent of the non-owners have incomes under $15,000 a year and three-fourths of them have incomes under $30,000 a year. For owners the reverse is true. Over half have incomes over $30,000 a year, and more than 1 in 5 have incomes in excess of $50,000 a year.

CHARACTERISTICS OF IRA OWNERS AND NON-OWNERS

	IRA Owners	IRA Non-Owners
Age		
Under 30	7.5%	20.8%
30-39	20.8	23.3
40-49	22.6	15.4
50-59	30.9	12.4
60-64	12.0	7.7
65 and Older	6.2	20.4
Education		
High School Graduate or Less	28.2%	46.7%
Some College	31.1	29.5
College Graduate	21.6	14.9
Graduate School	19.1	8.9

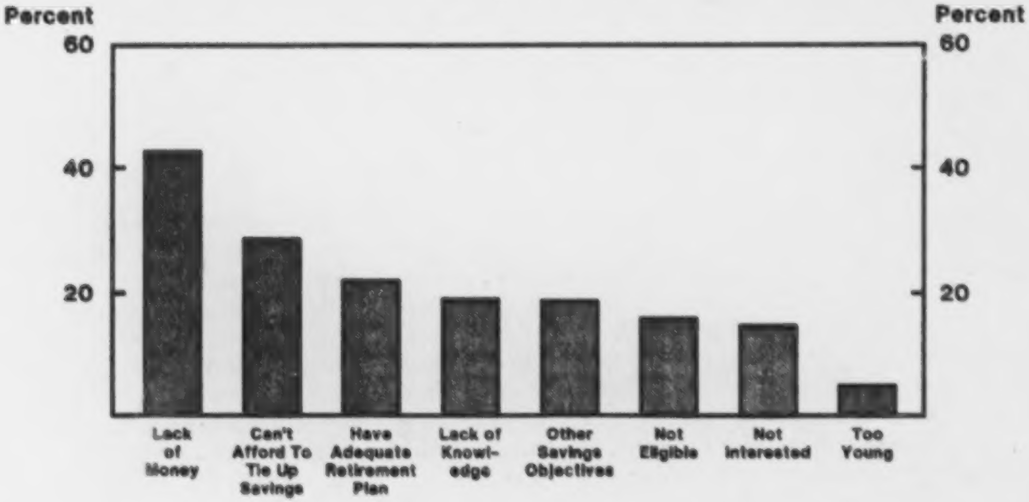
LACK OF MONEY WAS CITED MOST FREQUENTLY AS THE REASON FOR NOT OPENING AN IRA

Given the income levels of non-owners, it is not surprising that the primary reason mentioned for not opening an IRA was the lack of money. More than 40 percent of the non-owners indicated that they had not opened an IRA because there was nothing left over after paying their living expenses. A variation on this theme was the reluctance to tie-up their savings in an IRA. These two reasons were more important to those under the age of 50 and those with incomes under $30,000 a year. As noted earlier, most non-owners who are eligible for IRAs fall in these groups.

Non-owning households with higher incomes placed less emphasis on lack of money and more on the fact that they already have an adequate retirement plan. They also indicated that they have other savings objectives, such as the education of children. Older non-owners frequently said they were not eligible for IRAs or were retiring soon so that an IRA was not viewed as worthwhile.

Nearly one in five of the non-owners indicated a lack of knowledge about IRAs. They said they did not know about IRAs or they needed additional information about them. This reason for not opening an IRA was more prevalent in the younger (under 40 years) age groups.

REASONS FOR NOT OPENING AN IRA



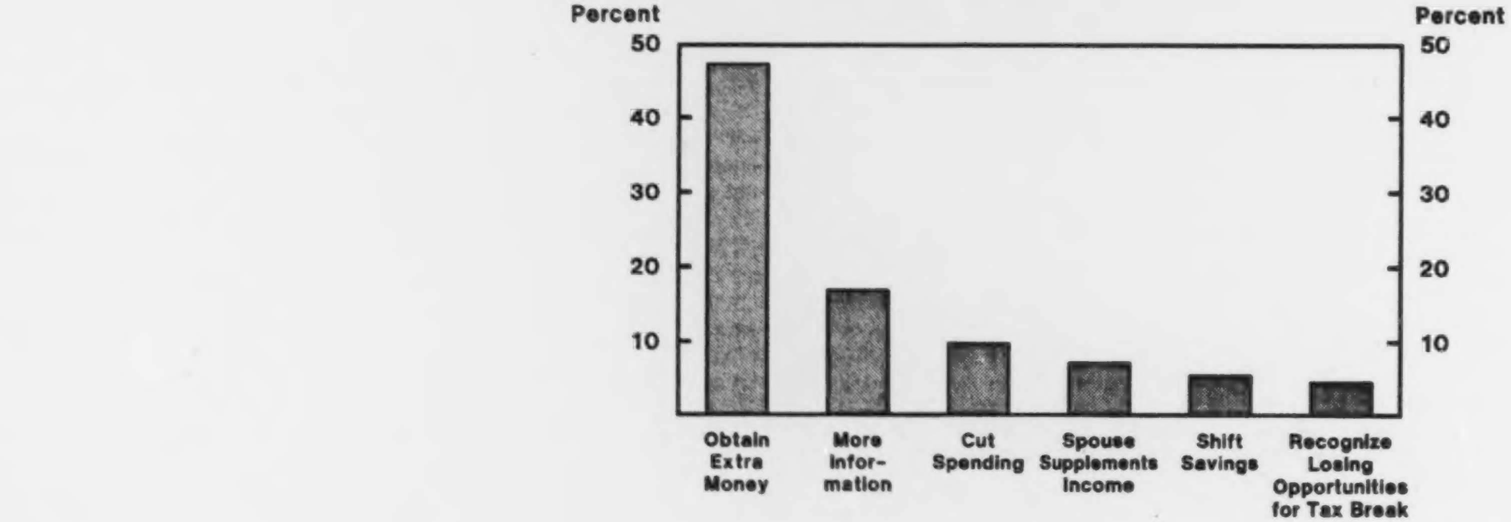
MANY HOUSEHOLDS WILL REQUIRE MORE MONEY AND INFORMATION BEFORE THEY OPEN AN IRA

Most non-owners said that it was not at all likely that they would open an IRA in the 1984 tax year. While this was especially true for lower income households, it was also true for those in higher income brackets. As expected, the event most vital in deciding to open an IRA in the months ahead is obtaining extra money. Nearly half of the non-owners gave this answer. Closely associated with this response, a portion of the non-owners said that their spouse would have to obtain work which would supplement the total household income. One in ten said they would have to cut spending in order to be able to save in an IRA.

A significant percentage said that they would have to obtain more information about IRAs which convinced them it was a good idea. This was particularly true for the younger non-owners. Only a small portion said that the realization that the opportunity for a tax break on 1984 income was slipping away would prompt them to open an IRA. If income is not sufficient to open an IRA, the availability of the tax break is obviously not relevant to the decision.

As mentioned earlier, many non-owners have lower incomes and are less likely to have adequate pension coverage through their employer. These people are most in need of supplementing their retirement income, but they are least likely to be able to do so because they lack the funds to invest in an IRA.

EVENTS VITAL TO DECISION TO OPEN AN IRA



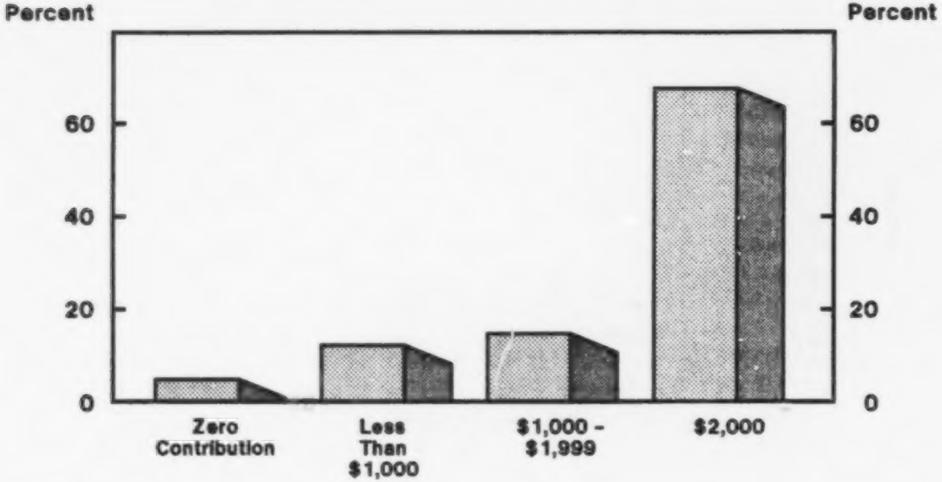
MOST OWNERS ARE ALREADY CONTRIBUTING THE MAXIMUM AMOUNT ALLOWED TO THEIR IRAS

A shortage of money is obviously a key stumbling block that many individuals must hurdle before they become IRA owners. Some of this group might be more inclined to become owners, however, if they understand that they are not compelled to contribute the full $2,000 each year to their IRA. In practice, people set aside as much as they can and, if unforseen contingencies arise, they may skip a year. As the accompanying chart shows, about 1 in 20 owners of individual IRAs contributed nothing to their accounts in tax year 1983, while more than 1 in 4 contributed less than $2,000. The majority of owners of individual IRAs, however, (almost 7 in 10) contributed the maximum amount to their accounts. As might be expected, IRA owners with incomes of $30,000 or more added the full $2,000 to their accounts more frequently than those with lower incomes.

Owners with spouse-employed and spousal IRAs made the maximum contribution with even greater frequency than owners of single household IRAs. Approximately 76 percent of the owners of spouse-employed IRAs and about 90 percent of the owners of spousal IRAs contributed the maximum allowed. The higher contribution levels of these latter two groups probably reflect the fact that their total family income is, on balance, higher than those households who own only one IRA.

Up to this point our report has reviewed: The origins and growth of IRAs; competition among types of financial institutions for IRA business; consumer awareness of IRA features and how they are used; and the attitudes and characteristics of IRA owners and non-owners. We will now move to assess the reactions of respondents in our survey to proposals which would make IRAs more attractive to people in all walks of life. A number of these proposals -- in one form or another -- are part of the current legislative agenda.

SIZE OF CONTRIBUTION TO INDIVIDUAL IRAs IN TAX YEAR 1983



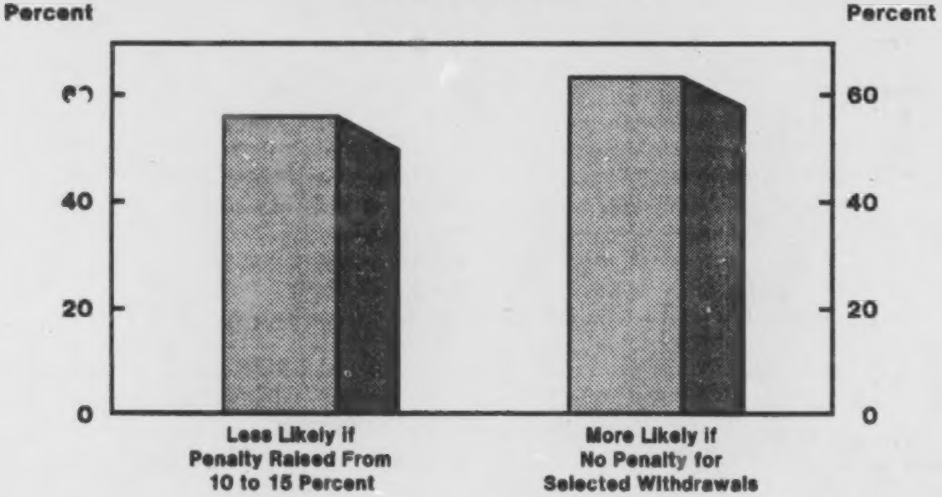
EASED WITHDRAWAL RESTRICTIONS WOULD INCREASE THE LIKELIHOOD OF NON-OWNERS OPENING IRAS

Survey findings discussed earlier clearly indicate that lack of money and/or ready access to it is a major factor preventing large numbers of individuals from becoming IRA owners. Given their special situations, it also seems likely that many of this group are "turned off" by a provision in the current law which imposes a penalty if IRA dollars are withdrawn from the account prior to age 59-1/2. In order to test this hypothesis, non-owners were asked about their likelihood of becoming IRA owners if: (a) Penalties were raised from the current 10.0 percent to 15.0 percent, and (b) Penalties were eliminated on withdrawals for the purchase of a principal residence, education expenses, or financial emergencies.

As shown by the bar to the left, about 56.0 percent of the non-owners indicated that they would be even less likely than at present to become IRA owners if withdrawal penalties were raised. Answers to the second withdrawal question, however, were much more positive. More than 6 out of 10 non-owners said they would be more likely to open an IRA in tax year 1984 if penalties were waived on withdrawals for selected purposes. Many in this group, however, would undoubtedly still lack the motivation or the income to actually become owners in the near-term.

Almost 3 in 4 of this latter group had incomes under $30,000. At the same time, 6 in 10 were under age 40. These are people who, by and large, have a limited capacity to save for retirement. In addition, they are in a stage of their life-cycle where they will need to draw upon available savings during pre-retirement years.

IMPACT OF EARLY WITHDRAWAL PENALTIES ON THE WILLINGNESS OF NON-OWNERS TO OPEN AN IRA



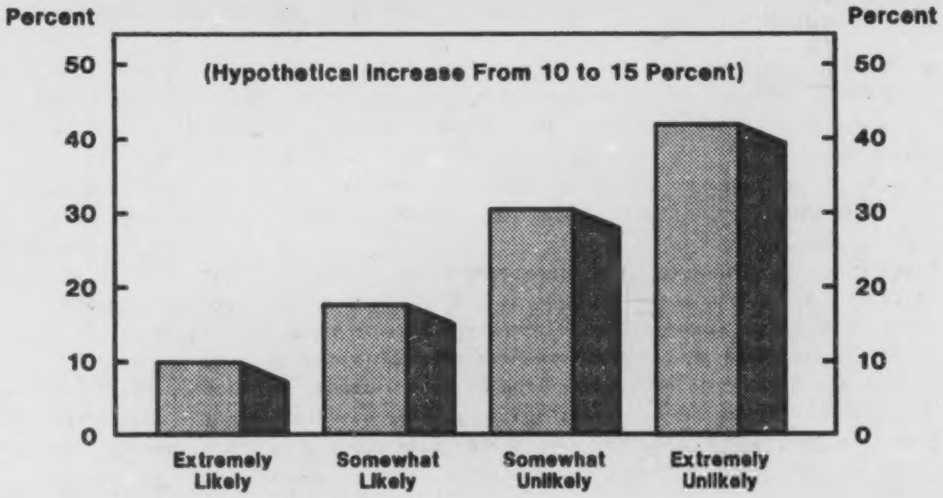
AN INCREASED WITHDRAWAL PENALTY WOULD HAVE LITTLE IMPACT ON IRA OWNERS' CONTRIBUTIONS

Owners of IRAs were also queried about their reactions to penalties on early withdrawal from their accounts. The question asked was: "If the current penalty of 10.0 percent was raised to 15.0 percent, what is the likelihood that you would contribute less to your IRA in the future?" The answers are displayed in the accompanying chart.

More than 7 in 10 owners said it would be extremely or somewhat unlikely that they would contribute less to their IRAs. At the other end of the scale, less than 3 in 10 said that it was extremely or somewhat likely that they would cut contributions. In analyzing the answers, it is evident that there is some tendency for older, better-educated people with higher incomes to say that increased penalties would not influence their IRA contributions. Perhaps the strongest impression, however, is that this attitude is widespread. On the other hand, those that are likely or somewhat likely to cut IRA contributions tend to have incomes of $30,000 or less and to be under 40 years of age. These responses are apparently from people who are "on the margin" in terms of their willingness and ability to set aside savings for long-term goals.

The overall responses to this question seem to add up to this. Once individuals have found the wherewithal to open an IRA and have made the commitment, the tax benefits and other advantages of being able to save for an important objective like retirement more than offset the disadvantages of increased withdrawal penalties.

LIKELIHOOD THAT OWNERS WOULD CONTRIBUTE LESS TO THEIR IRAs IF THERE WAS AN INCREASE IN THE PENALTY FOR WITHDRAWING FUNDS PRIOR TO AGE 59-1/2



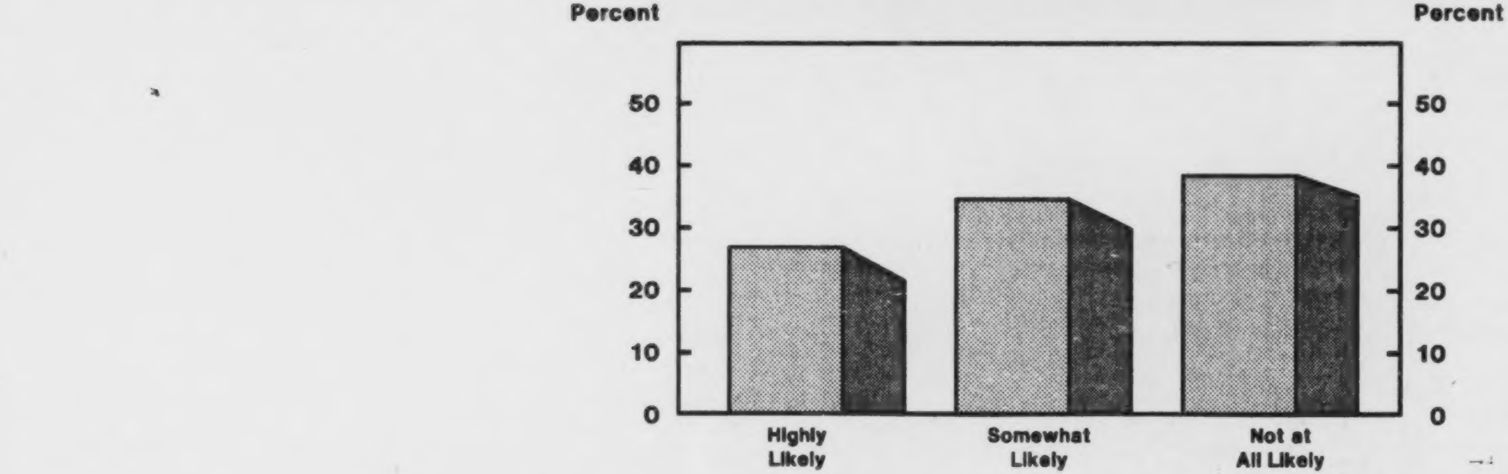
MANY PEOPLE WOULD LIKE TO MAKE ADDITIONAL CONTRIBUTIONS TO THEIR INDIVIDUAL IRAS

Many IRA owners not only don't want to cut back their contributions, they want to increase them. This conclusion flows from the following survey question: "If you could make an additional contribution to your IRA during the 1984 tax year, which would not be tax deductible, but the earnings on which would accumulate tax-free, how likely is it that you would make such a contribution in addition to your tax deductible contribution?" The answer: More than 6 in 10 owners responded that it was highly or somewhat likely that they would make additional contributions given these circumstances.

Those IRA owners who said they would add to their contributions were also asked this follow-up question: "How much would you contribute during the 1984 tax year (beyond the $2,000 tax deductible contribution)?" As might be expected, the additional amounts spanned a wide range. About 65 percent of this group said they would make additional contributions of under $2,000; 16 percent said they would add between $2,000 and $3,000; and 19 percent said they would increase their contributions by more than $3,000.

IRA owners with incomes of $40,000 or more represented a significant proportion of those who said they would make additional contributions of $3,000 or more. People between the ages of 40 and 60, however, accounted for a large share of all owners who said they would add to their contributions. The implication appears to be that, as people mature, the goal of accumulating retirement dollars has great appeal, even if the tax benefits are minimal.

LIKELIHOOD OF OWNERS TO MAKE AN ADDITIONAL CONTRIBUTION TO THEIR IRA WHICH WOULD NOT BE TAX DEDUCTIBLE BUT WHOSE EARNINGS WOULD ACCUMULATE TAX FREE



THE ADMINISTRATION'S PROPOSAL TO INCREASE IRA LIMITS IS A STEP IN THE RIGHT DIRECTION

As part of the survey, IRA owners were also asked how they would react if they were able to make an additional deductible contribution of up to $2,000 for the non-working spouse rather than the current $250. As can be seen in the accompanying chart, about half of the respondents said they would add to their existing account. One-fourth indicated that they would open an account, presumably because it would now be of a size that seemed worthwhile. Less than one-fourth of the group said they would neither open an IRA nor add to it.

The present Administration recognizes the inequities inherent in the existing concept of the spousal IRA and is taking steps to eliminate them. In the Administration's current proposal to increase IRA limits, it is stated that:

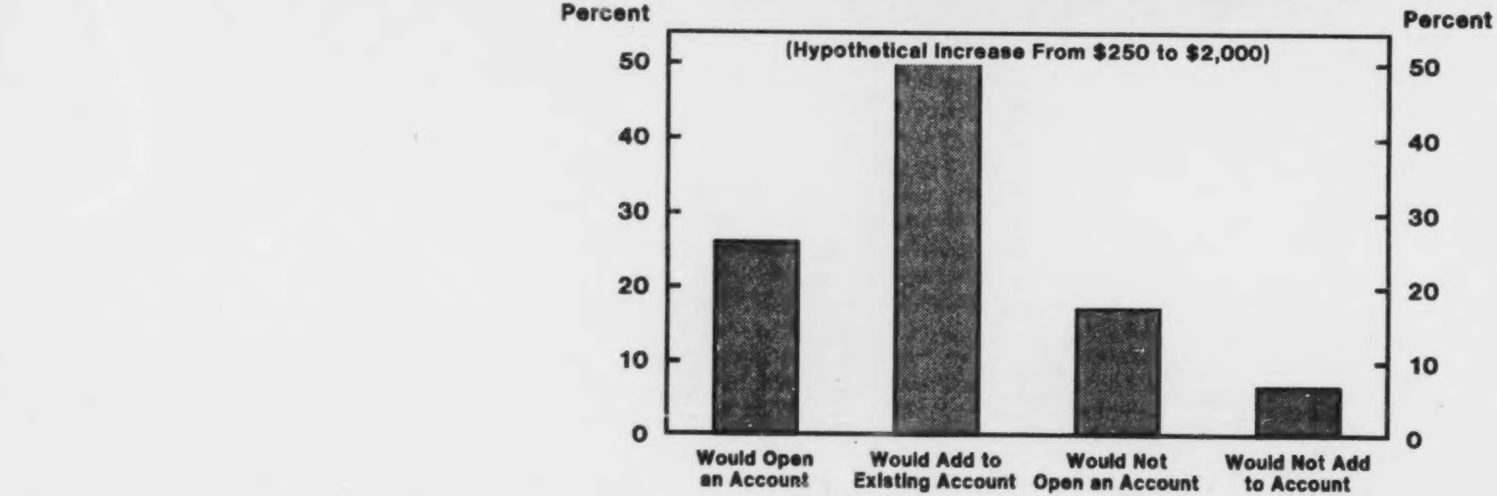
> "The existing limitations on IRA contributions are illogical and inequitable as applied to married couples. The relatively minor allowances for a spousal IRA fail to recognize the important economic contributions made by nonearning spouses. Moreover, they are inconsistent with other rules of current law under which married couples are treated as an economic and taxpaying unit..."

The Administration proposes to increase both the working-individual's IRA and the spousal IRA to $2,500 each or a joint $5,000. The Administration goes on to say that:

> "This would not only enhance individual retirement security, but should also contribute to increased capital formation and productivity."

Results from the Institute's survey -- previously discussed -- have already demonstrated the magnitude and broadly-based nature of this enhancement to retirement security. Now, we will focus on findings which show that IRAs have also helped improve the level and composition of total savings.

REACTION OF IRA OWNERS TO EXPANSION OF DEDUCTIBLE CONTRIBUTIONS FOR NON-WORKING SPOUSES



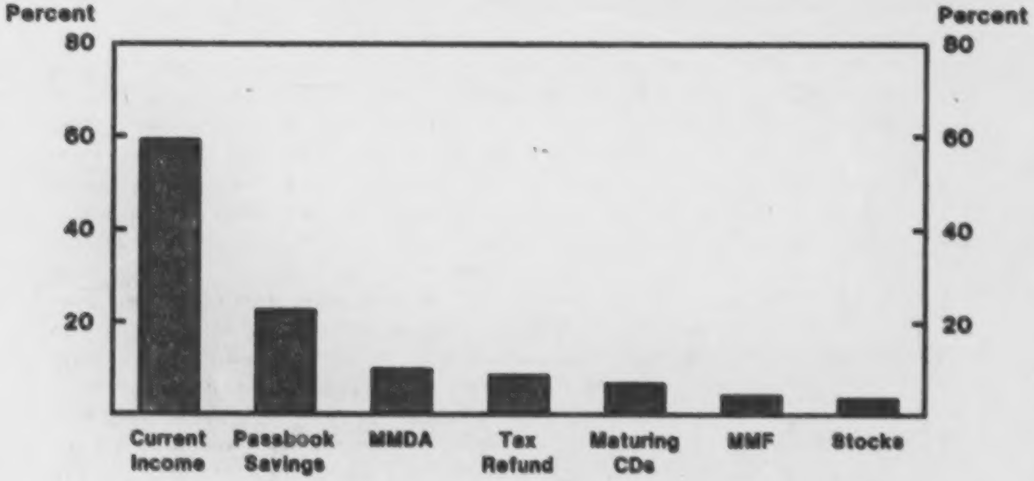
CURRENT INCOME IS THE MOST FREQUENTLY CITED SOURCE OF IRA CONTRIBUTIONS

One of the first things we did to measure the impact of IRAs on saving was to estimate the sources of money used to finance IRA contributions in tax year 1983. The crucial element in this exercise is the need to distinguish IRA contributions which came from current earnings or other current income from those which were financed out of prior savings or investments. In an effort to obtain accurate responses, respondents were instructed not to count dollars as prior saving if they came out of current income or earnings but were temporarily placed in checking accounts or other forms of saving. Respondents were likewise instructed that IRA contributions involving these kinds of "pass throughs" should be considered current income and earnings.

The accompanying chart displays the responses. Almost 6 in 10 respondents indicated that some part of the money contributed to their IRAs in the 1983 tax year came from current income. About 1 in 5 drew money out of low-yielding passbook savings. The primary remaining sources included money market deposit accounts, money market mutual funds, maturing certificates of deposit, tax refunds, and other financial assets. The percentages associated with the various sources used to finance IRAs add to more than 100 percent since some respondents checked more than one source.

While IRA owners with incomes of $50,000 or more checked current income as the source of their contributions with somewhat greater frequency than others, virtually all groups relied heavily on this source to finance at least a portion of their IRA contributions. This implies that, for many people with moderate to low incomes, saving through IRAs represents a large share of their total saving.

SOURCE OF MONEY FOR IRA INVESTMENT



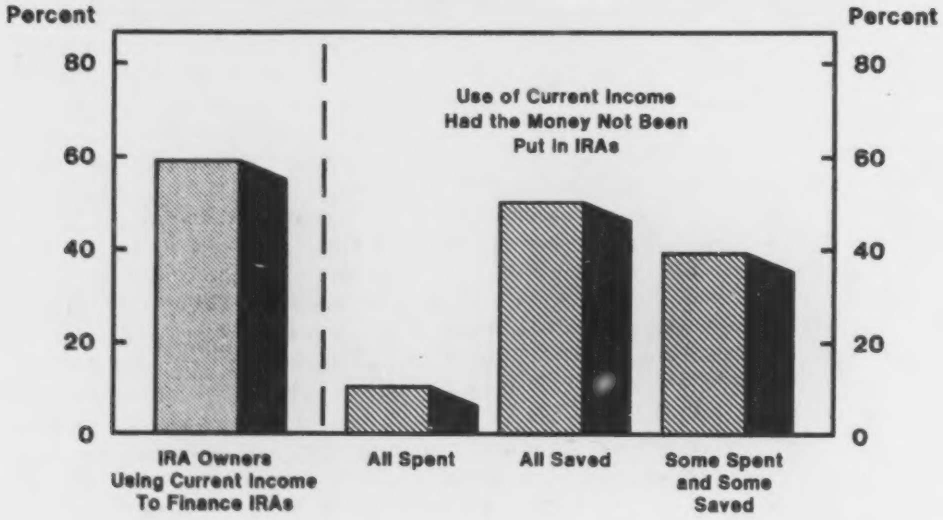
IRAS INCREASE SAVING

In seeking to assess the impact of IRAs on total saving, it is not enough to estimate the percentage of owners who said they used saving out of current income to finance their contributions. If, for example, these contributions were simply a substitute for another type of saving, there would be no net addition to total saving. In order to clarify this point, we asked; "Had you not put your money into your IRA during the 1983 tax year, how would the money have been used?"

Approximately half of the IRA owners who said they used current income to finance their contributions said they would have saved or invested the money anyway. About 1 in 10 said they would have spent it all. An additional 4 in 10 said they would have spent some and saved some. It is these latter two groups that form the basis for our net savings calculations.

From the survey data, we estimated the average IRA contribution of the group that would have spent all of the money had they not put it in an IRA. We also calculated the average contribution for the group that said it would have spent some and saved some; then, we determined how these contributions were allocated. Finally, we multiplied the estimates of the average dollar size of the IRA contributions by the appropriate size of the groups in the U.S. population. The final numbers indicate that the availability of IRAs contributed at least $10 billion to total saving in 1983 which, in the absence of IRAs, would have been spent. This estimate of the impact of IRAs on total saving should be regarded as "approximate" since it is based on a sequence of questions (and calculations), some of which are relatively complicated. What is reassuring, however, is that the answers appear reasonable and internally consistent.

SAVINGS OUT OF CURRENT INCOME
HAD THE MONEY NOT BEEN PUT IN AN IRA



IRAS ALSO HELP CHANNEL SAVINGS INTO LONGER-TERM INVESTMENTS

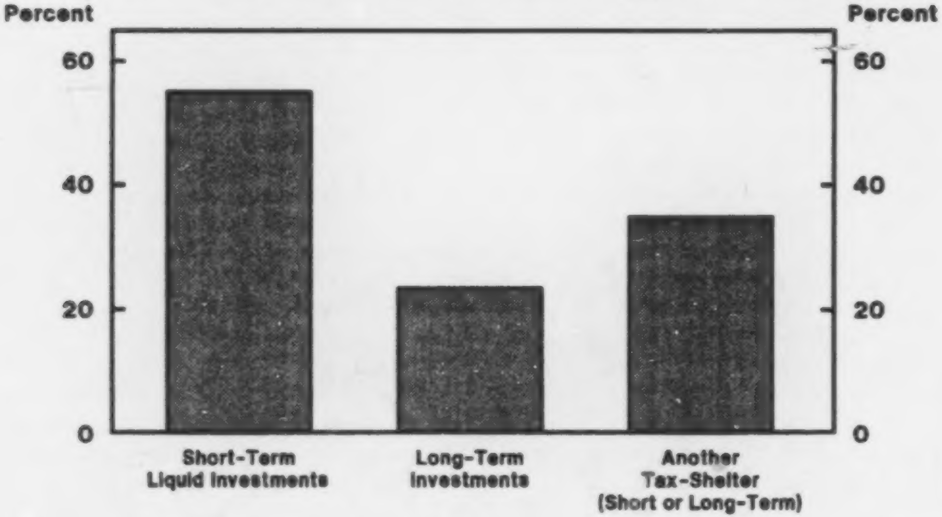
Quite apart from the net impact on total saving, it is reasonable to expect that IRAs add to the pool of money available to finance longer-term investments, such as plant and equipment, residential and commercial building, and other productive activities. In order to test this assumption, we probed further.

For those IRA owners who indicated that they would have saved had they not put their money in IRAs, we sought to determine how they would have saved or invested the dollars set aside. Approximately 35 percent said they would have selected another tax-sheltered investment (either a short or long-term investment vehicle); about 23 percent said they would have chosen a long-term investment vehicle; and over 50 percent indicated they would have invested the money in short-term liquid assets which they could get at easily. Thus, by diverting these dollars into IRAs the stability of the total savings pool is increased and the supply of dollars available for long-term investment purposes is enlarged.

The overall findings in this important area of public policy are worth repeating. IRAs have not only boosted saving, they have changed its composition -- channelling relatively more into long-term investments which help finance the productive capacity of the nation. In short, IRAs result in substantial benefits to both individual users and the economy at large -- benefits that would undoubtedly be enhanced if the IRA program were liberalized further.

TYPE OF SAVING SELECTED

HAD THE MONEY NOT BEEN PUT IN AN IRA



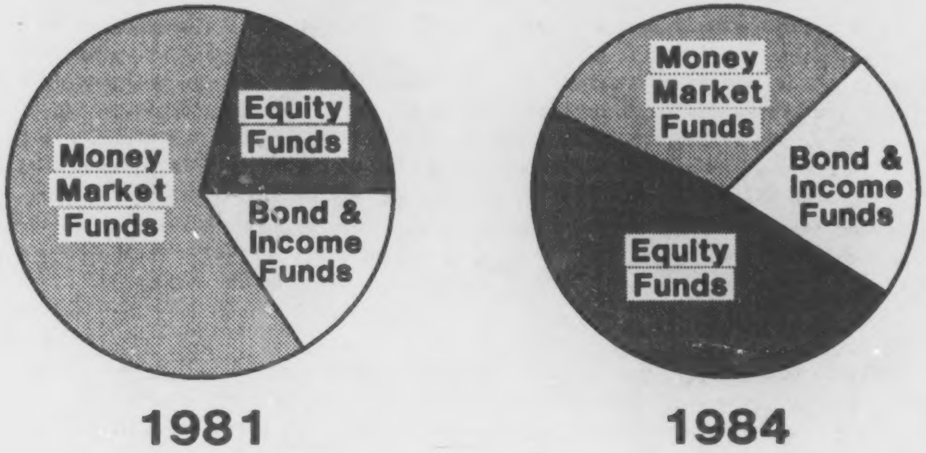
IRA OWNERS UTILIZING MUTUAL FUNDS AS IRA FUNDING VEHICLES ARE SHIFTING TOWARD EQUITY FUNDS

As we have seen, IRAs are helping to channel savings into longer-term investments. It should be emphasized, however, that this movement has been reinforced in recent years by a significant improvement in the overall economic-financial environment -- a change which has operated to increase peoples' willingness to make longer-term investment commitments. In capsule form, the improvement may be described as follows: Inflation has been reduced to a more tolerable level; inflationary expectations have been dampened; and interest rates are down, particularly in the short-term area. These forces have operated to both "push" and "pull" people into longer-term investments. The "push" stems from the fact that short-term investments no longer pay a huge differential over long-term investments. In fact, the competitive advantage has shifted to long-term investments at the same time the public's view of the longer-term economic outlook has become more sanguine.

The forces just described, combined with a positive stock market, have produced a significant shift in the way mutual fund shareholders -- an extremely perceptive group -- fund their IRAs. As the accompanying chart shows, the total volume of mutual fund IRA assets funded with money market funds (MMFs) fell from about 63 percent at the end of 1981 to about 30 percent at the end of 1984; most of this drop was offset by equity funds whose share rose from 21.0 percent to 48.0 percent; bond and income funds also increased their share of IRA assets.

In summary, our changing economic environment has been accompanied by a decline in the relative importance of MMFs as funding vehicles to achieve long-term goals, like retirement. MMFs, however, continue to play an important role in providing IRA owners and other investors with liquidity (easy access to savings) and a safe harbor between security transactions. They also represent a continuing important way of saving, particularly for people who are unwilling or unable to assume investment risk.

IRA ASSETS INVESTED IN MUTUAL FUNDS



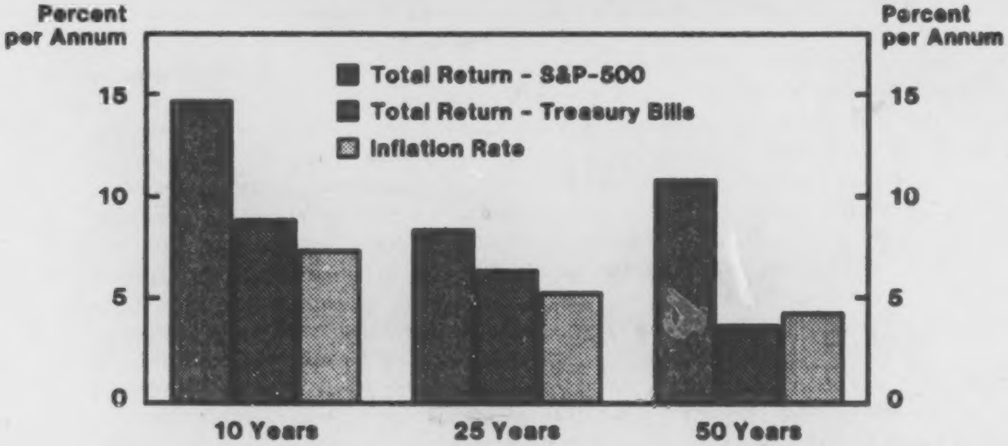
IRA INVESTORS SHOULD SERIOUSLY CONSIDER PLACING A PORTION OF THEIR IRA DOLLARS IN EQUITY MUTUAL FUNDS

History shows that, over the longer-term, investments in stocks produce significantly higher returns than Treasury bills. Since returns for stock mutual funds and savings certificates are not available for a 50-year time span, returns on equities and Treasury bills are used as proxies in the accompanying chart. The bottom line, however, is that IRA investors -- particularly those with time on their side -- should consider placing a portion of their IRA dollars into equity mutual funds. Let's look at the record.

In the ten years ending December 31, 1984, stocks -- as measured by the S&P-500 -- produced a per annum rate of return of 14.7 percent, much higher than either the inflation rate or the annual return on Treasury bills. Although levels were generally lower, stocks enjoyed an even larger relative advantage over both bills and the inflation rate during the past 50 years. The competitive advantage of stocks over bills has been somewhat smaller in the past 25 years; even so, stocks achieved a per annum rate of 8.3 percent versus a 6.3 percent return for bills. The positive differential of two percentage points for stocks may not seem like much, but through the magic of compounding it makes a difference of $5,468 on $2,000 invested over this 25-year span.

Despite the return advantages that stocks have over many competing investments, some investors may still be concerned about their volatility. While stock prices are volatile in the short-run, the probability of a high positive return increases substantially with the length of the holding periods. Between 1925-1984, for example, per annum returns on stocks for fifty 10-year periods ranged from a low of -0.9 percent to a high of 20.1 percent. Equities produced negative returns in only 2 out of 50 ten-year periods; and their returns exceeded bills, bonds and the inflation rate 37 out of 50 times. Bills, on the other hand, produced ten-year returns of between 0.1 percent to 8.8 percent and beat inflation in only 23 of the 50 ten-year periods.

STOCKS, BILLS, AND INFLATION (PERCENT PER ANNUM)



NOTE: Compiled from data published by Roger G. Ibbotson and Rex A. Sinquefield for the year 1926 through 1976 (Stocks, Bonds, Bills and Inflation, Financial Analysts Research Foundation, Charlottesville, VA., 1977) and updated through 1984 by CDA Investment Technologies, Inc., Silver Spring, MD.

THE SPECIFIC CHALLENGE:
PROVIDE IRA INVESTORS WITH THE INFORMATION THEY NEED TO MAKE CHOICES AMONG COMPETING ALTERNATIVES

Many IRA owners are looking at an investment time horizon of between 10 and 40 years. Consequently, all but the most risk averse should consider the possibility of placing at least a portion of their IRA investment in equities. For those inclined toward this view, stock mutual funds offer an efficient way to take such a position. As noted earlier, equity mutual funds offer diversified portfolios, professional management, and they have performed well over the long-term. In the past ten years, for example, the average equity fund has produced a per annum return of about 15 percent.

The changing economic environment -- mentioned earlier -- may be the catalyst which will prompt more IRA investors to consider long-term investment alternatives. Individuals with IRA accounts at depository institutions, for example, should recognize that returns currently available on savings certificates and other deposit products are down substantially from those offered in the early eighties. Those IRA owners that recognize what's happening may respond by shifting to a stock, bond, or income mutual fund. Many investors, however, may stay where they are because they are not aware of differences in returns on competing funding vehicles.

In an Institute-sponsored survey conducted in the Fall of 1983, respondents from upper-income households were asked what annual rates of return they expected to receive on selected saving-investment products over the next several years. As may be seen in the accompanying table, fund owners who funded their IRAs with mutual funds perceived distinct differences among the returns on the types of financial products surveyed. Other IRA owners, however, were much less perceptive. This lack of knowledge about returns is part of a larger communications gap which limits the ability of many consumers to make rational choices among competing alternatives.

Median Expected Annual Rate of Return

	Fund Owners		
Type of Savings or Investments	IRA With Fund	IRA Not With Fund	Non-Fund Owner With IRA
Individual Stocks	12.3%	10.4%	10.2%
Money Market Funds	10.0	9.9	10.5
Common Stock Fund	12.0	10.3	10.0
Savings Certificate	9.3	9.6	9.7
MMDA	9.5	9.8	10.0
Fixed Rate Ins. Annuities	8.7	8.9	9.0

THE LARGER CHALLENGE: EXPAND THE PUBLIC'S FAMILIARITY WITH MUTUAL FUNDS AND HOW THEY MAY MEET PARTICULAR NEEDS

In our current survey, we sought to determine respondents' general familiarity with mutual funds. The findings -- shown in the accompanying table -- reaffirm what we already know: Large segments of the population still have limited familiarity with mutual funds and how they may meet particular needs. Owners funding their IRAs with mutual funds indicated high levels of familiarity with them. That 4.2 percent of the respondents in this group said they were not at all familiar with funds may reflect their use of advisors. People not funding their IRA with mutual funds and those who are non-IRA owners frequently stated that they were not at all familiar with mutual funds.

Many households obviously need additional information about mutual funds and other investment alternatives, if they are to have a chance to arrange their IRA and other financial asset holdings in ways which allow them to maximize returns and minimize risk. In the absence of relevant information, many households gravitate toward those financial products with which they are most familiar, namely deposit products of various kinds. An excessive concentration of total asset holdings in deposits is unlikely to be in the long-term financial interest of many households.

Mutual fund companies -- and other types of financial institutions -- have generally done an excellent job in describing their old and new products. The public has responded by absorbing a good deal about them. From the consumer's standpoint, however, it is like chasing a moving train. The faster you run, the farther you fall behind. Consequently, many prospective consumers are still in the dark about many financial alternatives that might satisfy their needs.

FAMILIARITY WITH MUTUAL FUNDS BY IRA OWNERSHIP

	IRA Funded With				
	Mutual Funds	Deposit Accounts	Stocks/ Bonds	Other	Non IRA Owners
Very Familiar	36.8%	18.8%	28.4%	18.4%	7.6%
Somewhat Familiar	59.0	56.8	63.5	53.4	46.6
Not at All Familiar	4.2	24.4	8.1	28.2	45.8

LAW OFFICES
LEVIN AND WEINHAUS
1602 EXECUTIVE BUILDING
515 OLIVE STREET
ST. LOUIS, MISSOURI 63101-1895

MORRIS J. LEVIN
S. SHELDON WEINHAUS
JEROME J. DOBSON

AREA CODE 314
621-8363

March 28, 1985

Honorable William Clay, Chairman
Subcommittee on Labor-Management Relations
U. S. House of Representatives
2451 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Clay:

We have written to you from time to time both in your role as Chairman of the Subcommittee and as a St. Louis Congressman whose constituents have been personally affected by Alpha Portland's unilateral termination of health insurance benefits promised "for life" to those retirees. I have often in the past complained about the manner in which this well-heeled corporate giant has been able to manipulate the judicial system to create long delays, thus preventing the "ready access" and "remedies" Congress mandated in Section 2(b) of ERISA.

I recently thought the two-and-one-half-year delay in this case would be over and the plan benefits finally restored when the Eighth Circuit Court of Appeals finally decided en banc on January 16, 1965, by a seven-to-one vote, that Alpha's delaying arguments were phony and inappropriate. But I regret to report I was wrong to believe the judicial system was finally working as Congress intended, to protect pensioners. As per the enclosed order, the Eighth Circuit has refused to return the matter to the district court for relief and is allowing Alpha further delay, so Alpha can appeal to the Supreme Court. I do not object to appeals, but in this case the retirees are suffering terribly from the denial of adequate health care while Alpha is given substantially all the time it wants to delay. Worse yet it appears that Alpha is now engaged in a scheme to divert and dilute assets, to which I refer in paragraph 4 on page 6 of the enclosed objections. Alpha intends that even if the retirees ultimately win there will be nothing to collect.

If it is of any help to you or the Subcommittee in your review, when Alpha asked the court of appeals for further delay I opposed the stay on behalf of the retirees. I enclose copy of my statement to the court revealing at the bottom of page 7 the suffering Alpha's conduct is causing and on pages 4 through 7, Alpha's judicial misconduct. Alpha asked the Eighth Circuit to strike my charges because they put Alpha in such a bad light, but as you will see by the enclosed order the appeals court allowed my opposition statement to fully stand.

I again urge you and your Subcommittee to investigate into this matter and consider legislation to prevent the continued abuse of the legal system to destroy a helpless, aged population.

Respectfully,

Sheldon Weinhaus

SW:jc
encl

September 26, 1984

STATEMENT OF SHELDON WEINHAUS, ATTORNEY FOR HOURLY RETIREES OF ALPHA PORTLAND INDUSTRIES TO SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS

On May 1, 1982 Alpha Portland Industries, Inc., a New York Stock Exchange company, terminated its life and health insurance benefits plan for all its retirees from plants in nine different locations, including St. Louis, Missouri, Birmingham, Alabama, Jamesville, New York, Cementon (Catskill), New York, Lime Kiln, Maryland, Ironton, Ohio, LaSalle, Illinois, Orange, Texas, Martins Creek, Pennsylvania and Manheim, West Virginia. This affected some 450 retirees nationally, and at least another 200 of their dependents. Retirees ranged from the mid-40's to above 90. Several retirees died without satisfactory levels of medical care that the plan would have provided; others have had their health threatened and diminished due to anxiety and lack of high quality care the plan provided; at least one lost his home to pay medical bills; others were turned away by medical providers who wouldn't provide services without prompt payment. Able-bodied elderly retirees were forced to seek menial jobs to try and get insurance coverage; other family members were forced to find work to pay off medical bills. Those with pre-existing medical conditions couldn't even buy adequate coverage even if they were to scrape up the money to pay the insurance premium; many couldn't afford to buy any coverage.

Alpha promised in collective bargaining sessions that such insurance for hourly retirees would continue until death. Alpha's summary plan description required by ERISA, said "for life." When retirees sought to process their claim for wrongful termination under ERISA Section 503, Alpha simply used the 90 days the Secretary of Labor allowed for claims processing to delay, for Alpha advised the court that they are able to save some $200,000.00 every month coverage is denied. When the retirees sued in federal court, Alpha got the federal court in St. Louis to find the retirees "undeserving," even though practically ever other federal court, including federal appeals courts, find retirees deserving and demand the insurance continue.

The district court in St. Louis wouldn't let the hourly retirees sue, finding the dispute arbitrable, even though the Supreme Court now holds that ERISA cases are trust cases to which labor arbitration rules don't apply. Alpha has even refused the retirees' offer to arbitrate all issues before Arthur J. Goldberg, former Supreme Court Justice.

A panel of the Eighth Circuit said in January, 1982, that arbitration was not required. But at Alpha's request the entire court granted rehearing. Some ten months later the appeals court still has not decided. This case gives real meaning to the concept that "justice delayed is justice denied"; no court is able to restore life, health or abode. In the meantime Alpha has already appropriated for its own uses, according to its own sworn cost figures and including the interest saved, over $6,000,000.00 that it should have spent on insurance benefits for retirees.

Alpha's attorney threatened that if plaintiffs ever find a way to get the court to hear their claim, the poor, financially strapped and demoralized retirees will face the fight of their lives and that even if they win a judgment Alpha will take such steps to assure there will be no assets on which to collect. Alpha's own 1982 financial report shows a rich and lush company. Alpha clearly believes that the courts will protect it from paying anything for its misconduct, that the "worst" the court will do will be to simply have Alpha reinstate the plan without paying damages. It also seeks to stop retirees from obtaining preliminary relief by demanding the retirees post a bond it knows they can't afford.

The retirees' attorney asked the Secretary of Labor to enter his appearance and help protect the retirees since even those over 65 and able to buy supplemental Medicare coverage stand to be hurt even more as the "medigap" enlarges under current administration planning, a gap that retirees would not have if the Alpha plan had not been terminated. Thus far the Secretary has shown no inclination to be concerned that Alpha isn't living up to its promises and federal common law. Workers need more protection than the protection Congress thought it was giving to this older generation.

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

No. 83-1358-EM September Term, 1984

Robert Anderson, Jr., et al.,
Appellants,

vs.

Alpha Portland Industries, Inc., etc., et al.,
Appellees.

Appeal from the United States District Court for the Eastern District of Missouri.

Appellants' motion for stay of mandate is granted. The stay of the issuance of the mandate is stayed to and including April 1, 1985. If within that time there is filed with the Clerk of this Court a certificate of the Clerk of the Supreme Court of the United States that a petition for writ of certiorari has been filed, the stay hereby granted shall continue until the final disposition of the case by the Supreme Court.

Appellants' application for attorneys' fees is denied at this time.

Appellees' motion to strike opposition to stay of mandate is also denied.

March 25, 1985

IN THE
UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

ROBERT ANDERSON, JR., et al)
)
Plaintiffs-Appellants,)
)
v.) No. 83-1358
)
ALPHA PORTLAND INDUSTRIES, INC.,)
etc.,et al)
)
Defendants-Appellees.)

OPPOSITION TO STAY OF MANDATE AND REQUEST FOR SANCTIONS AND OTHER APPROPRIATE RELIEF

NOW COMES plaintiffs/appellants and request the Court to forthwith issue its mandate and to impose sanctions against Alpha Portland Industries, Inc. (Alpha). The analysis below suggests Alpha's request and representations seek to prostitute the judicial system. Sanctions are appropriate for Alpha's conduct in seeking delay, in attempting to prevent any adjudication for preliminary relief, and in allowing for additional time to divert and dilute assets, as well as continue a course clearly intended to "soften up" any resistance to the usual pattern of cheap employer buy-outs in these cases.

I.

1. As its first ground Alpha misstates the basis for this Court's granting of reconsideration en banc. The specific written reason given to the parties was that the decision in Robbins v. Prosser Moving & Storage Co., 700 F.2d 433 (1983) was then to be reviewed by the Supreme Court. Alpha particularly directed its motion for reconsideration to Judge John R. Gibson, specifically suggesting to Judge Gibson that he would likely change his concurring vote if the Supreme Court reverses notwithstanding Judge Gibson in his concurrence agreed with other reasons advanced by the panel decision writer, as further witnessed by this Court's en banc decision authored by Judge Gibson.

RECEIVED
FEB 8 1985
U.S. COURT OF APPEALS
EIGHTH CIRCUIT

When ultimately the Supreme Court affirmed Robbins in Schneider Moving & Storage Co. v. Robbins, 104 S.Ct. 1844 (1984), Mr. St. Vrain advised that Chief Judge Lay made inquiry whether the case would not then be reconsidered without further argument or hearing, in response to which Alpha demanded opportunity for supplemental memoranda, causing delay of resubmission. When ultimately Alpha filed its supplemental memorandum it summarily gave only passing lip service to the Supreme Court decision in Schneider, supra, and the bulk of Alpha's rehearing argument was redirected to the same erroneous arguments presented to and rejected by the panel. Alpha continued to miscite, presume and bootstrap.

2. Alpha has failed to suggest and cannot suggest any significant issues left after the Supreme Court's decision in Schneider. There are none. This Court on page 5 of its slip opinion denied Alpha's argument of "conflict" in the circuits when it noted a big difference between "chooses" and the case here.

There is no reason nor rationale for Alpha to presume that the Supreme Court would want to so quickly review the wisdom of Schneider nor depart from long-established doctrines in Allied Chemical and Alkali Workers Local No. 1 v. Pittsburgh Plate Glass Co., 404 U.S. 157 (1971). Considering the 7-1 decision with even the dissent reversing the dismissal, the consistency of the decisions (panel and en banc) with all other decisions of the various courts of appeal, no reason exists to reasonably anticipate certiorari being granted.

3. The only issues that Alpha could present for certiorari are issues it has previously presented by deliberate miscitations and bootstrapping noted by this Court in its en banc decision.[1]

II.

The representation by Alpha that the issues raised on this appeal are "similar" with regard to a separate salaried retiree case filed against Alpha is false and fraudulent. Such representations constitute unethical and unprofessional conduct. As stated in the Appendix A, affidavit of counsel for the salaried retirees, the salaried retirees are not represented for collective bargaining purposes by any union, no collective bargaining agreement exists and there is no arbitration clause or plan referral language on which the district court earlier based its decision in the hourly retirees case. Alpha even so acknowledged when it bequiled the district court into condemning plaintiffs for frivolous positions.[2]

---

[1] Slip opinion p. 4 n.3 (Alpha's argument "is not an accurate characterization of this dispute."); p. 5 n.3 continued (Alpha "reads back into Schneider the very presumption in favor of arbitrability that the Supreme Court rejected."); p. 6 n.4 (Alpha's argument that the contract makes the union the exclusive representative for the retirees "presumes the issue -- a proper interpretation of the contract -- to be determined here."); p. 10 n.11 (Alpha's rehearing argument ignores the earlier panel decision in which the panel "underscored the inherent conflicts in relegating retirees to an exclusive remedy of arbitration controlled by a union which owes them no duty of fair representation."); p. 11 at n.12 (Alpha's argument that "this language [in the summary plan description] can be given no effect" is not supported by the case cited and further "this holding has been rejected in other circuits."); p. 8 (Alpha cited cases "do not justify its argument that the union has the exclusive authority to mediate the interest of a 'functionally distinct minority' which cannot be made part of the bargaining unit and which, as the Supreme Court pointed out, does not have a vote in union affairs."); p. 6 (Alpha confuses the interests of retirees with the interests of laid-off workers seeking severance pay); p. 5 (Alpha seeks to avoid the import of Allied Chemical Workers and Alpha miscites other cases by ignoring the fact that they deal solely with the question of "standing" of a union "if it chooses to litigate for retirees.")

The only issues that are similar are the similarity of some plan language on the merits, such as Alpha's obligation to continue retirees' benefits for life, the fact that the salaried plan historically followed the hourly plan with respect to benefits and retiree continuation, and the fact that Alpha would often over union protest improperly include costs for salaried employees with costs for hourly retirees.

III.

Alpha's assertion of good faith and claim that the motion is made in good faith and not for the purpose of delay is patently false.

1. Alpha waited until the very last day before mandate issuance before it filed its request for a stay. That request could have been prepared in two hours rather than 21 days. It should have been filed promptly after decision so as not to delay mandate

---

[2] Alpha's Opposition to Plaintiff's Application to Supplement Record stated:

"Defendants Alpha and the Plan oppose Plaintiffs' Application To Supplement Record. Granting the application would merely confuse the record by interjecting irrelevant, immaterial matter.

The key point that plaintiffs do not squarely address is that the proposed 'new evidence' deals solely with a single salaried employee formerly employed at Alpha's cement plant in Texas. The status of salaried retirees is totally irrelevant for at least two reasons.

1. This case does not involve any salaried retirees. Plaintiffs are all hourly retirees from Alpha's St. Louis plant who have no demonstrated connection with the Texas plant. They never purported to represent salaried retirees as part of their proposed class action.

2. The dispositive issue in this case has been plaintiffs' failure to exhaust the grievance procedure that was created by collective bargaining and by collective bargaining made the mandatory method of resolving differences concerning the hourly Plan. Salaried retirees were never represented by a union. There was never any collective bargaining agreement defining or limiting the rights of salaried retirees or providing for a grievance procedure culminating in arbitration to resolve differences over those rights."

issuance if this Court was to have sufficient time to consider the request without any adverse consequences resulting from the request.

2. Alpha gives no reason why it needs until April 1st to prepare a petition for writ of certiorari when the issues have been repeatedly briefed, once below and twice before this Court. Alpha is represented by a firm of over 250 lawyers, and it has recently merged with the experienced St. Louis labor law firm of Spoehrer and Lemkemeier, so that the manpower is readily available. As it is, eight separate attorneys have been named on various pleadings. Alpha's 1983 annual report to shareholders shows a stockholder equity of over 46 million dollars so Alpha can easily afford expeditious preparation. The need for so much time to seek certiorari suggests no good faith in seeking delay.

3. Alpha originally opposed plaintiffs' request for expedition made to this Court when the appeal was originally taken, notwithstanding that in this type of case the courts regularly recognize the grave harm that denial of medical insurance to retirees foretells.[3] Steelworkers v. Ft. Pitt Casting Div., 598 F.2d 1273 (3rd Cir. 1979); Gulf Coast Industrial Workers Union v. Exxon Co., 114 LRRM 2016 (5th Cir. 1983); Auto Workers Local 645 v. General Motors Assembly Div., 112 LRRM 3345 (DC Ca. 1982); Auto Workers v. White Farm Equipment Co., 5 EBC 2449 Civil No. 4-84-770 (DC Minn. 10/19/84); Local Union No. 150-A, United Food Workers v. Dubuque Packing Co., No. C83-1037 (ND Iowa 4/26/84).

---

[3] The district court on March 3, 1983, refused to address plaintiffs' request for preliminary relief below for the reason that plaintiffs "eschew" an arbitration procedure this Court twice found they had the right to eschew. Judge Hungate said the retirees must bear the brunt of any delay. His holding still stands notwithstanding panel and en banc reversals.

The district judge's concluding remarks in that decision suggest he may have arguably intended not ruling on the request for preliminary relief not to cause more human suffering but to assure there would be no appeal to this Court because of his believe that plaintiffs could and would not be successful on appeal. However, we can ill believe the district judge intended his punitive decision to result in a three-year delay he still attributes to plaintiffs.

4. As per the sworn statement in Appendix B hereto, Alpha has actually threatened to take measures to cause delay and has in fact threatened to assure that assets would not be available when ultimately the retirees are ever allowed to recover judgment. As shown by the first exhibit attached to the affidavit in Appendix B, while this matter has been on appeal Alpha obviously considered and took steps to dilute and/or divert corporate assets. Delay herein will permit Alpha to carry out its wrongfully threatened schemes to thwart the judicial system and the fair administration of justice.

5. That when plaintiffs sought preliminary relief from this Court after Alpha sought reconsideration, Alpha in opposition to consideration of such relief falsely represented to this Court that on September 23, 1982 plaintiffs had agreed to abandon and give up their claim for preliminary relief. This falsity is explained in Appendix C.

6. For each month Alpha can delay, its affidavits filed in the trial court reveal it saves $200,000 a month. Alpha has now saved by the delay since plan termination, when interest is also considered, some eight million dollars more or less. This further delay Alpha now seeks, will allow it to appropriate, with continued interest, almost another million dollars. The delay will work solely to the advantage of Alpha, and as noted in paragraph 3 above and in Part IV hereinbelow, it will continue to cause irreparable injury and harm to the retirees.

7. Alpha's proposal for arbitration in the trial court was fraudulent and to delay. Alpha clearly intended to resist arbitration as the dissent feared possible. As per the affidavit in Appendix B, plaintiffs' counsel proposed on February 7, 1984, that any and all issues any party wanted —plan, contract, law, including procedural issues and liability of subsidiaries, be arbitrated; that the arbitrator be the Honorable Arthur J. Goldberg, former Secretary of Labor, former Justice, former Ambassador; that the arbitrator's decisions and orders be final and binding and unreviewable, with the federal judiciary's only role to be the enforcement of all orders and decisions issued by Justice Goldberg;

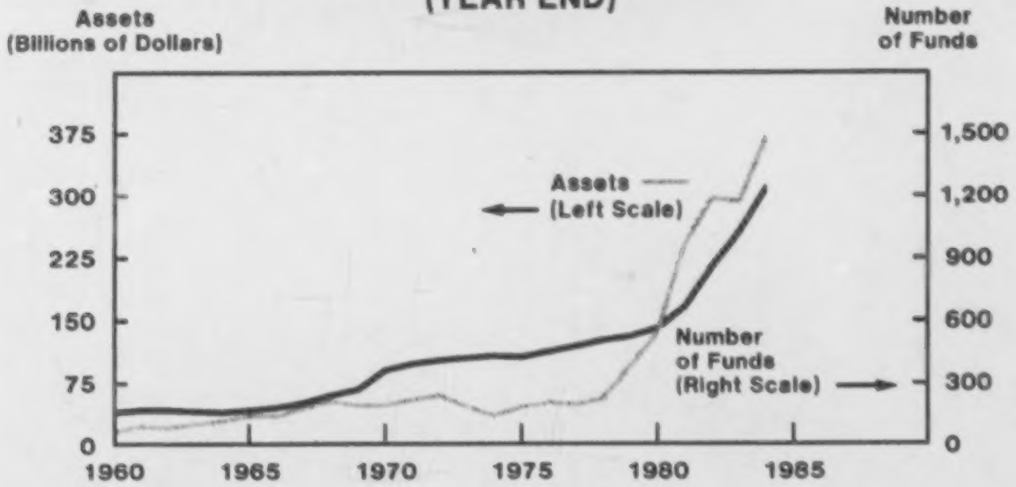
GROWTH OF THE MUTUAL FUND INDUSTRY IS AN INDICATION OF ITS SUCCESS IN REACHING THE PUBLIC AND SATISFYING ITS NEEDS

The industry will continue to make a concerted effort to expand public awareness and knowledge of the variety of mutual fund products now available. Although there is much to be done, there is solid evidence of progress. As the accompanying chart shows, the fund industry has responded to the changing financial needs of investors by substantially increasing the number and types of funds offered. There are now about 1,200 funds compared with about 500 at the start of this decade. The current total includes: stock funds, bond and income funds, money market funds, and limited maturity municipal funds. In addition, there are stock funds with different return-risk characteristics and bond and income funds of different types and maturities. The wide range of choice, the quality of the products, and the flexibility provided through exchanges, are all significant factors increasing the public's demand for fund products.

Total assets of all types of funds amounted to $371 billion at the end of 1984, compared with $94 billion at the start of this decade. Over this same period, shareholder accounts of all types rose from under 10 million to almost 29 million. Since the mutual fund business is essentially a "people business", it is extremely gratifying that many investors have concluded that it is wise and profitable to have a portion of their savings managed by mutual fund professionals.

The fact that a large portion of the U.S. population still has limited awareness of mutual funds is both a challenge and opportunity. The challenge is to find better ways to tell the public how their savings-investment goals may be met through mutual funds. The opportunity is to continue to increase the industry's share of the expanding financial services market. We confidently expect to improve our position in both of these areas in the years ahead.

TOTAL ASSETS AND TOTAL NUMBER OF FUNDS
ALL TYPES OF FUNDS
(YEAR END)



that the retirees be represented by counsel instead of any union; and that as is often found in the cement industry, that Alpha agree to pay the expenses of arbitration. Considering the district court's willingness to find Alpha in good faith and anxious to arbitrate, wouldn't Alpha have "jumped" at this arbitration proposal? The proposal was given the silent treatment, ignored and hence rejected. Alpha does not and never wanted a fair arbitration. It certainly doesn't want binding arbitration from a person of such stature as a retired Justice of the United States Supreme Court. It wanted delay or a stacked deck. The delay the trial judge freely gave it in retribution for the retirees eschewing arbitration.

IV.

The stay of the mandate that Alpha seeks will irreparably harm and prejudice plaintiffs/appellants as follows:

1. As stated in paragraph 4 of Part III, p. 6 supra, Alpha is using this period of delay to divest itself of and dilute its assets to prevent recovery.

2. The delay has and is seriously harming and irreparably injuring the retirees. We attach as Appendix D hereto a letter recently received from the family of a class member who retired from Alpha's Lime Kiln, Maryland plant. The letter demonstrates the cruel devastation and destruction that Alpha's misconduct and the delay is visiting upon human beings. Corrected here for spelling only, it states

> "16 Jan 1985
>
> My Grandmother is a sick and old lady who has many medical problems. She could afford to nor could my Grandfather to have the attention he needed as he suffered with cancer of the lung and brain. He could not breath without oxygen, which we kept at home. My Grandfather was bedfast and needed attention around the clock.
>
> This put a lot of strain on my Grandmother and kept her blood pressure and nerves in a constant fit. Plus she was not able to move him around in bed and do so without hurting him and herself.

> She was once a cancer victim and has only one eye, half a side of her face and throat as it was removed due to cancer. She also had mild heart seizures and today is not over his death and hasn't recovered physically or emotionally from having to keep him at home so much, because of having no insurance.
>
> I don't know exactly what you want but she will supply you with information you want. As I her grandson am helping her financially but I don't have a drivers license and have difficulty getting to work to help her. We are having a family effort to pay bills because of my grandfather's sickness. She only gets a pension of $300.00 a month which is just enough to cover her medicine and doctors visits which are often. She also is deaf in one ear and she gave my Grandfather a bell to ring so she could hear him better in the night. It was hard on her trying to sleep so she could hear him, as he could just barely be heard when listening close. You have my Grandmothers permission to write or print in your words what you want to and ask for more information.
>
> Signed Mrs. Blanche Longerbeam
> His wife
>
> /s/ Blanche M Longerbeam
>
> P.S. They my Grandparents had to go from Charlestown Hospital to Winchester Hospital which is 35 miles driving their self for my grandfathers treatments. If you want bills from the Hospitals and doctors, we can try to get receipts as my grandfather got lung cancer, was treated went for a while and then got brain cancer, then lung cancer again at the same time, then is spread all over. He suffered, so did my grandmother. She was and is worrying about bills that cant be paid because of his sickness. His pension when alive helped pay for them but now he gone and so we can't pay them all as we once did."

The district court could not have devised a more cruel and unusual, inhuman punishment if it wanted retribution for the plaintiffs' resisting arbitration by a union unwilling to arbitrate for them after agreeing to "exclude" their vested retiree benefits.

4. Alpha cannot really mount satisfactory opposition on the merits. Alpha several times acknowledged in writing that the continuation-of-benefits language in the plan meant "until death" and "for life." On far poorer facts than here other courts have held words like "continue" and "provide" vest retirement insurance benefits upon retirement. Allied Chemical and Alkali Workers Local No. 1 v. Pittsburgh Plate Glass Co., supra, 404 U.S. at 181 n.20, 182; Auto Workers v. Cadillac Maleable Iron Co., 728 F.2d 807 (6th Cir. 1984); Auto Workers v. Yard-Man, Inc., 716 F.2d 1476 (6th Cir. 1983) cert den'd 104 S.Ct. 1002 (1984); Auto Workers v. Federal Forge, Inc., 583 F.Supp. 1350 (WD Mich.

1984); Local Union No. 150A etc. v. Dubuque Packing Co., supra, In re White Farm Equipment Co., 5 EBC 2169 (ND Ohio 1984); Eardman v. Bethlehem Steel Corp., 5 EBC 1985 (WD NY 1984); Hansen v. White Farm Equipment Co., 5 EBC 2130 (ND Ohio 1984); Bower v. Bunker Hill Co., 725 F.2d 1221 (9th Cir. 1984).

Plan termination even violates ERISA fiduciary duties. Calhoun v. Falstaff Brewing Corp., 478 F.Supp. 357, 361 (DC Mo 1979), opinion after trial sub nom Dependahl v. Falstaff Brewing Co., 491 F.Supp. 1188 (DC Mo 1980), modified on other grounds, 653 F.2d 1208 (8th Cir. 1981) ("to argue that the employer may terminate such plans at any time without violating the statute is clearly not supportable in the statutory language nor in equity.").

5. Delay Alpha seeks is also intended, as the Supreme Court noted in Clayton v. Auto Workers, 451 U.S. 679, 693 n.22 (1981), to further wear down resistance to Alpha's later attempt to seek a cheap buy-out. The Steelworkers' amicus brief to the Supreme Court in Massachusetts Life Ins. Co. v. Russell, No. 84-9, suggests that in the medical benefit termination cases the next thing to anticipate is a unilateral lump sum settlement offer, in the nature of a cheap "buy-out," as in the Colt Industries case. Amicus brief p. 19 n.16. Colt Industries wasn't alone in making individualized settlement. This Court en banc at page 6 of its slip opinion noted that that is what occurred in UAW v. Yard-Man, Inc., 716 F.2d 1476, 1483 and n.9 (6th Cir. 1983), cert den'd 104 S.Ct. 1002 (1984). After being without benefits and observing the power that Alpha has thus far exercised by its defenses and judicial manipulations to delay Congressionally mandated "ready access," which period of delay will be three years if Alpha's request to stay the mandate is granted to await the outcome of a certiorari petition, with the district court's March 3, 1983 memorandum decision still blaming the retirees for the delay in reaching the merits, plaintiffs and many class members will be far too frightened, far too confused, far too unprotected -- many in fact dead -- not to seize whatever pittance Alpha later offers. The district court in concluding remarks had already prejudged Alpha's good faith.

CONCLUSION

WHEREFORE, for the foregoing reasons plaintiffs/appellants ask the Court to issue the mandate forthwith, to impose sanctions on Alpha and to order expedition on remand.

Respectfully submitted,

LEVIN and WEINHAUS

By Sheldon Weinhaus

Sheldon Weinhaus, MBE #16699

515 Olive Street, Suite 1602
St. Louis, MO 63101
314/621-8363

Attorneys for plaintiffs

PREPARED STATEMENT OF DWIGHT K. BARTLETT, III, PRESIDENT, MUTUAL OF AMERICA LIFE INSURANCE COMPANY

I am Dwight K. Bartlett, III, president of Mutual of America Life Insurance Company. Mutual of America is a tax-exempt, nonprofit corporation which is limited by its charter to underwriting employee benefit plans for non-profit health and welfare agencies. Mutual of America's predecessor, National Health and Welfare Retirement Association, was founded in January 1945. The organization's founding fathers, who were primarily voluntary and professional leaders of the predecessors to United Ways and the organizations which they supported, sought to assure employee benefit programs for the staff members of their agencies.

Today, Mutual of America, which became our organization's name in 1984, is licensed in the District of Columbia and 47 states. While its home office is in New York City, it has opened field offices in key cities throughout the country. At the end of 1984, Mutual of America was underwriting 32,000 employee benefit plans for approximately 13,000 non-profit health and welfare organizations. Its policyholders include many of the nation's prominent publicly-supported charitable organizations, such as United Ways, the Girl Scouts of America, Goodwill Industries, the Council of Jewish Federations, American Cancer Society, Association of Junior Leagues, as well as other hospital, philanthropic and charitable organiations. Pension plans insured by Mutual of America include both defined benefit and defined contribution plans. Typically, the pension plans of Mutual of America's policyholders are small with twenty or fewer participants.

Mutual of America congratulates the subcommittee for holding these hearings on employee benefits and the need for a national retirement policy. The development of such a policy is long overdue. The accelerated adoption of piecemeal legislation, such as DEFRA, ERTA, REACT, TEFRA, etc. has created a volatile environment in the pension field which discourages adoption of employee benefit plans, makes their administration more and more expensive and prevents their rational development in keeping with the needs and interests of employees, employers and our society as a whole. Where there needs to be predictability and stability there is continued uncertainty; where there needs to be clarity and simplicity, there is increasing complexity. It is hoped that these hearings and the deliberations which follow will lead to the formulation of national policy based on a consensus about the role of retirement plans in the social and economic life of the nation.

The suggestions set forth in this statement are intended to make a contribution toward that end. Three principles underlie these suggestions:

1. While recognizing that Social Security , employment retirement plans and individual savings each must play an important part in assuring adequate income in retirement, for most employees the first two are key and deserve priority as far as government policy is concerned;

2. Programs ostensibly to encourage savings for retirement should be limited to that purpose and should not be available for other purposes however desirable such purposes might be.

3. Tax policy to provide incentives for retirement savings should be neutral among various kinds of retirement plans, such as defined contribution or defined benefit plans, so that employees can enlist in plans on the basis of their retirement needs. It is appropriate, however, for policy to recognize special needs of employees in particular employment sectors.

Each of the suggestions that follows does not fall neatly under one of these policy principles. Nevertheless, for ease of discussion, the suggestions are explored in the context of the principle to which they seem most closely related.

--Primacy of Social Security and Employee Benefit Plans

Individual savings certainly should be encouraged. Our savings rate in the United States for the liquid capital needs of the country is much lower than rates in other Western industrial nations. However, for low income and moderate income workers, Social Security and employee benefit plans are bound to be the mainstays of their retirment. The lower the income, the less disposable income an individual or family will have for savings. In addition to the small amount of such savings, the evidence is that individual retirement savings as encouraged by IRAs do not meet a substantial part of participation and coverage needs at these income levels. In view of this reality it is essential to preserve the value of the Social Security benefit, to recognize the need for higher replacement ratios for the lower and moderate income worker and to preserve the value of the employee retirement benefit.

--Preserving the Social Security Benefit

Social Security cash benefits are the bedrock of our retirement system. Changes in the system should only be made for the purpose of protecting the system's short and long range requirements. The 1983 amendments assured that the program will be adequately financed both for the short and long term. Proposals to make further changes for purposes extrinsic to the system, such as reducing the deficit, should be rejected. To arbitrarily reduce benefits without a corresponding adjustment in Social Security tax rates will lead to short term overfinancing and raise the hazard of new benefit liberalizations or fund diversions which could, in turn, lead to new crises or shocks to the system in future years. Moreover, a cutback of benefits through a COLA reduction to reduce the need for government borrowing is really a subsidy from Social Security recipients to other recipients of Federal expenditures, since the Social Security system requires no borrowing to pay benefits. Such a subsidy not only appears to be unfair but diverts spending discipline for other areas where it probably needs to be exercised. The 1983 amendments already have imposed revenue and expenditure discipline on Social Security programs.

In any event, adjustment to the COLA formula, if it is to be done, should be done as a deductible rather than a cap or waiver. A deductible is consistent with the sound insurance principle that beneficiaries should be able to self insure a small portion of the loss of purchasing power of their Social Security benefits, but should be protected against a sharp jump in inflation or a catastrophe, such as a return to double digit rates. A deductible, such as giving a benefit increase equal to the increase in the CPI, less 2%, might also be said to recognize that inflation costs to retirees tend to lag the costs to consumers, generally.

--Revising Rules for Integration of Pension Plans with Social Security

Perhaps nowhere is the confusing and costly impact of patch work legislation more evident than with respect to integration rules. The failure to modernize these rules for many years has led to a proliferation of other cumbersome devices for preventing abuses of tax preferences accorded pension plans. The so called "top heavy" rules provide perhaps the worst outcome of these undoubtedly well-intentioned efforts. These rules adopted in part in lieu of change in integration rules, bear very heavily and inappropriately on relatively small not-for-profit charitable and welfare organizations. They should be repealed. Similarly, limitations under Section 415 of the Internal Revenue Code should be unnecessary, in view of current nondiscrimination provisions, if integration rules were appropriately and fairly structured.

What is needed are easy to understand and administer integration rules that apply across the board, take into account current and expected Social Security benefit levels and reflect the fact that high replacement rates are justifiable for low to moderate income employees, while higher income employees require significantly lower replacement rates to maintain their standard of living in retirement.

1. Preserving the Purchasing Power of Vested Pensions

Proposals have been made to establish a governmentally administered portability fund to protect the vested pensions of individuals as they move from job to job in their careers. The need for that kind of fund might be greatly reduced if two requirements were imposed on qualified defined benefit pension plans.

The first requirement would be that whenever cost of living adjustments are provided plan annuitants, those same adjustments would be applied to the vested pensions of former employees who are not eligible to withdraw benefits.

The second requirment would be to allow terminating employees with vested pensions to transfer the actuarial value of those pensions to an IRA account. The actuarial value of the accrued vested pension would be calculated on the same interest assumption as is used in the actuarial valuation. Thus there would be no immediate actuarial gain or loss to the plan and no resulting immediate cost effect.

To the extent interest rates tend to follow inflation, as they do imperfectly, the purchasing power of a vested benefit rolled over to an IRA would tend to be more economically stable than that of a fixed dollar vested pension which remained part of the plan. As a simple illustration, assume for example that the interest rate assumption in the actuarial valuation of the plan is 6%, the annual investment return of the IRA 9%, and that inflation is at 3% per year. If the present value of a $100 monthly benefit vested for a participant who was 40 years old when he or she left the plan's employer were placed in an IRA, the benefit purchase at age 65 would be about $200 per month which would keep pace with inflation. If the inflation rate were 4% a year, only 25% of the purchasing power would be lost as compared to a 63% loss if the vested monthly benefit of $100 were payable.

A vested benefit rolled over to an IRA in these special circumstances should not be available to a participant as a distribution, even with a tax penalty, until age 59 1/2. This view is in keeping with the earlier stated principle that savings which are tax favored to encourage accumulation of retirement funds should not be used for other purposes. This principle is discussed in more detail in the next section.

2. Maintaining Retirement Savings for Retirement

Basic pension plans are established to provide financial security in retirement. Earlier lump sum payments, withdrawals or loans tend to defeat this purpose and thus weaken the prospects of individuals providing adequately for replacement income in retirement. Moreover, because of the short term attractiveness of programs that allow these capital diversions, such programs may be actual disincentives for long term retirement savings. Finally the statutory provisions, regulations and rules which seek to establish conditions for those various forms of early withdrawal add considerable complexity to pension fund administration.

These laws, regulations and rules are often inconsistent and unclear. The definition of a "hardship withdrawal" under 401(k) plans, for example, is yet to be clarified. In addition, they are often invitations to abuse. For example, when loans are made from the tax sheltered earnings of the participant's account; the loan is in fact an advanced payment of the accumulated funds. Nevertheless, the participant is permitted to deduct the interest paid on the "loan" and thus reduce the taxable earnings of the advance payment which he now controls.

Retirement savings should not be subject to lump sum withdrawals or loans prior to retirement. If withdrawals are permitted they should be taxed as current income in the year withdrawn.

3. Retirement Policy Should Be Neutral Except Where Designed to Meet Special Needs Inadequately Served

--Defined Benefit Versus Defined Contribution Plans

An apparently unintended effect of the pension legislation and regulation since ERISA has been to favor defined contribution plans over defined benefit plans. EBRI data demonstrate the rise of defined contribution plans over the last decade. Specific factors leading to this growing preference for defined contribution plans include the greater costs associated with defined benefit plans, such as the annual premium for plan termination insurance, the need for periodic actuarial valuation, and the potential liabilities to the plan sponsor in case of plan termination with inadequate resources. In fairness, to these must be added the impact of the accounting rules recently proposed by the Financial Accounting Standards Board.

Mutual of America believes that defined benefit plans are socially more desirable than defined contribution plans. Defined benefit plans, by definition, provide a benefit in retirement, based on a formula derived from assumptions as to an employee's work history and earnings and time of retirement and therefore are highly predictable. The formula is frequently worked out so that in combination with Social Security the resulting benefit will allow for full maintenance of standard of living in retirement for a long-service employee. Defined contribution plans are not predictable as to income in retirement and therefore tend to be thought of more as capital accumulation vehicles rather than income replacement plans. By comparison with defined benefit plans, they also tend to treat shorter service employees at retirement less favorably.

In our view it is very important that no steps be taken which would encourage further the trend toward defined contribution plans. Some of the proposals previously mentioned, dealing with improved portability, updating and simplification of integration rules, elimination of section 415 and section 416 limits, together with elimination of loan provisions, and lump sum payments on termination of employment, normally present only under defined contribution rules, would restore balance in the perceived merits of defined benefit plans and defined contribution plans as seen by potential plan sponsors.

--Increasing Coverage for Workers in Small Firms

The largest sector of noncovered workers is in small firms of 100 or fewer employees. A major disincentive to smaller firms sponsorship is the administrative complexity of pension plans. Suggestions that have been made earlier in this statement would do much to ease that complexity and resultant costs. In addition as recommended by the 1981 Report of the President's Commission on Pension Policy, Congress might allow small firms deductions at the maximum corporate tax rate for pension contributions and administrative costs in order to offset, in some measure, those costs to companies that often operate on thin margins.

--Maintaining Coverage for Workers in Non-Profit Organizations

Employees of many non-profit organizations have a special interest in the tax incentives for retirement benefits. Employees such as those of Mutual of America's policyholders tend to be less well paid than their counterparts in the commercial sector. Salaries are rising, albeit slowly, among non-profit employees, but the effects of years of low compensation continue to be felt by those employees who have been in the non-profit sector for a number of years with respect to planning for retirement. With very few exceptions, Mutual of America's policyholders simply cannot afford to offer the high-paying positions in which deferred compensation plans can make up for earlier low retirement savings. For this same reason, these are not the plans likely to be of a kind from which arise perceptions of abuse. But, these programs are also an important incentive used by Mutual of America's policyholders to encourage qualified applicants to accept lower paying jobs in the health and welfare sector. Thus, the employees and agencies with whom Mutual of America is concerned represent the group most likely to be severely affected by any changes in the tax treatment of employee benefit plans.

Moreover, for these reasons, as tax exempt entities, Mutual of America's policyholders have a particularly significant interest in maintaining the current tax-exempt or tax-deferred treatment of employer benefits to their employees. Because Mutual of America's employers are not eligible for the deductibility of contributions to benefit plans on their own tax returns, the tax treatment of these benefits to the employees becomes more important than it is to tax-paying employers. In fact, the tax treatment of employee benefits to their employees is the primary incentive for Mutual of America's policyholders to offer employee benefit programs. To the extent this treatment is reduced or restricted, the level of contributions by Mutual of America's policyholders would be likely to drop even more sharply than it would generally in the business community.

Many of these employee benefit plans for health and welfare organizations were established under Section 403(b) of the tax code, which provides for tax-sheltered annuity benefits for employees of eligible non-profit organizations. We believe that because of the special significance of incentives for non-profit employees, this provision should be preserved in any forthcoming legislation.

The subcommittee is embarked on work of great importance to all Americans to develop a national policy that will assure to workers and their families dignity and a decent quality of life in retirement. Private pension plans have a central and essential function in making such a policy a reality. It will take the best combined efforts of the Congress, plan sponsors, plan insurers and managers as well as the participation of workers for private plans to carry out their function effectively. In closing, we at Mutual of America want to thank the subcommittee for providing leadership in these efforts and giving us an opportunity to make a contribution toward their development.

PREPARED STATEMENT OF WILLIAM G. BAILEY, CIC, PRESIDENT, NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

The following statement is submitted by the National Association of Professional Insurance Agents (PIA) for inclusion in the hearing record of the Subcommittee on Labor-Management Relations, House Committee on Education & Labor, on April 2, 1985, on the importance of employee benefits to workers and the need for the private sector to be the primary provider of these benefits.

PIA is a national trade association representing 40,000 independent property and casualty insurance agents in all 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands.

PIA is also a member of a broad-based coalition of insurance, labor and business organizations opposing the proposed federal taxation of employer-provided benefits.

PIA shares the Reagan Administration's concerns about the strong need to reduce the federal deficit. Our concerns were made known in a letter to President Reagan on January 31, 1985. We also believe steps should be taken to raise revenues by broadening a tax base shrunk by too many loopholes. Further, we are mindful of the "fairness" problem: Some benefit plans confer a disproportionate amount of benefits for workers on higher-income employees; still other plans are no more than tax shelters.

Such inequities should be eliminated. Yet we are concerned that some tax proposals may go too far. Sweeping changes aimed only at raising revenue may ignore important social goals charted by the Administration. They may undermine an important aspect of financial security provided by the private sector.

Employer-provided benefits such as pensions, health insurance, life insurance and dental and disability coverage provide essential financial security for millions of American workers. Nearly 80 percent received health insurance coverage and 82 percent have paid pensions.

The advent of such group benefits has been a great assistance to smaller businesses such as many of the agencies run by PIA members, because it allows them to match larger employers in attracting and retaining quality employees. Taxing those benefits could jeopardize our ability to compete in this vital area.

A flat cap on tax-free employer-provided health benefits, for example, is not the best way to correct over-use of health services. A survey of PIA's membership (whose agencies average 4.5 employees) revealed that nearly all will be harmed by the proposed cap of $175 per month for family coverage and $70 per month for individual coverage. Most of our members would be hurt more than others. The average age of PIA members is 47, and the proposed tax would discriminate against older workers such as these, who pay more than younger workers for the same health care coverage.

PIA recognizes the strong need to reduce the federal deficit. However, it is essential that Congress not lose sight of the tremendous impact that employee benefits have on our nation's social and economic well-being.

Providing tax incentives that make benefit plans attractive to employers and employees helps the Administration further its laudable public policy goals of increasing the private sector's self-reliance and of decreasing dependence by our citizens on federal programs.

By encouraging the growth of private sector benefit plans, the government also supplements and strengthens the effectiveness of existing federal benefit programs such as Social Security, Medicare and workers' compensation.

However, the current proposed tax on private sector benefit plans would be a large step backward. So many employers and employees would be discouraged from participating in private plans that state and federal governments would be forced to step in and fill the void with costly programs of their own. Thus, our citizens would grow even more reliant to the federal government for basic security needs.

For those who still choose to participate in private benefits, the higher tax liability would weaken their financial security. And it would most harm the many millions of employees with marginal incomes -- who are among the very citizens whose security and independence the Administration most needs to ensure.

The proposed tax would also threaten the security and well-being of employees and their families in another important way: If the tax is imposed, employers and employees alike would re-evaluate their benefits status.

Employers are likely to reduce the spectrum of benefits available to workers. And employees are likely to decline portions of the protection available to them. Many employees would press to receive cash for other uses, instead of paying higher taxes on their benefit plans. This would leave these workers and their families dangerously vulnerable to financial disaster should serious illness, injury or other calamity strike a household without adequate coverage.

Thus, the proposed tax could create a long-term social problem in the U.S. by reducing the basic economic security of millions of workers and their families. Restricting or denying today's tax incentives for benefits would sacrifice valuable social goals and economic stability from the very core of the Administration's philosophy and social program.

PIA thanks the Subcommittee on Labor-Management Relations for this opportunity to comment. Employer-sponsored benefits allow today's workers and their families to enjoy financial security and health protection. It should be our nation's goal to continue moving forward in this area, not backward. You are entrusted with preserving this goal.

Older Women's League™
NATIONAL OFFICE
1325 G Street, N.W., Lower Level B, Washington, DC 20005
(202) 783-6686

STATEMENT
of the
OLDER WOMEN'S LEAGUE
to the
SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS
U.S. HOUSE OF REPRESENTATIVES
April, 1985

The Older Women's League (OWL), is the first national membership organization devoted exclusively to the concerns of midlife and older women. Founded in 1980 at the White House Mini-Conference on Older Women, OWL now has over 13,000 members and nearly 100 chapters. Through education, research and advocacy, we work for changes in public policy to eliminate the inequities older women face.

The Older Women's League commends the Subcommittee on Labor-Management Relations for its continued efforts to evaluate and strengthen retirement income policy. Retirement income is by far the issue of greatest concern to older women. This is why last year's passage of the Retirement Equity Act (REA) -- which amended ERISA to improve the delivery of retirement benefits and provide for greater equity under private pension plans for workers and their spouses -- was so vital to our constituency.

We would like to thank the members of this Subcommittee for their significant role in the enactment of REA, and particularly Chairman Clay, for his committed leadership and sponsorship. We appreciate the opportunity to share with you our views on the need for a national retirement income policy.

ECONOMIC STATUS OF OLDER WOMEN

Contrary to recent claims that the elderly have reached economic parity with the rest of the population and little further attention to them is needed, older women are far from "well off." A significant number of elderly -- mostly women -- live near poverty and could easily be pushed into poverty.

A crucial factor ignored by recent propaganda is that the elderly are not a homogeneous group and poverty rates are not uniform across the elderly population. Older women experience aging differently than men in the United States. On the whole, they are much poorer, live longer, and due to differences in marital status, tend to live alone.

From middle-age on, income decreases with advancing age, regardless of sex or race. At any adult age, however, there are dramatic differences between the incomes of men and women. Such differences carry into and have very adverse effects in old age. When data on income and poverty is shown by race and sex, it is clear that older women are disproportionately poor. Six out of 10 Americans over 65 and 7 out of 10 over 85 are women, yet women constitute 71% of the elderly poor. The special vulnerability of older minority women is particularly evident. Nearly 1 in 2 Black women over 65 live in poverty.

The median annual income of women over 65 in 1983 was $5,600 or about $800 above the official poverty level, and $4,000 below the median annual income of older men. These figures are less shocking if you assume that the "median man" and "median woman" are married, and living on a combined income. For the majority of women, this is not the case. While 77% of men over 65 are married and living with a spouse, only 39% of women are in similar circumstances. Women constitute 80% of the nearly 8 million elderly who live alone.

OLDER WOMEN AND PENSIONS

In theory, retirement security is provided through three primary income sources: Social Security, pensions and accumulated assets. In reality, it is not quite so well balanced. Most older women depend on Social Security as their only source of significant income.

Contrary to myths about overly generous pension plans and "double dippers," most older persons do not receive pensions. However, men are twice as likely to have pensions than women, as the following table shows.

Receipt of Pension Income by Persons Over Age 65 in 1983, by Sex*

	MEN	WOMEN
Total with pension	42.6%	20.4%
private only	29.8	11.4
military only	1.6	.3
federal only	4.1	2.1
state/local only	5.3	5.7
combinations	1.6	.6

---

*(unpublished date from 1983 Current Population Survey, Bureau of Census)

Thus, only one older woman in five currently receives a pension -- whether private or public, either as a spouse or as a retired employee. Not only do fewer women receive pensions than do men, but they receive considerably smaller pensions. The median monthly pension income for men was $473 in 1983 compared to $243 for women. Comparable figures from 1982 show the difference has widened by 7%.

The Older Women's League sets out to make all systems of retirement income more equitable and effective in their delivery of benefits. Our specific goals for the private pension system, the area of primary interest to the Subcomittee, are to promote quicker vesting, curtailment of integration with Social Security, greater portability and increased coverage. The following is a brief explanation of OWL's position on these issues.

Vesting

OWL supports measures to shorten the maximum required vesting time to five years and eventually three years. Most defined benefit plans, under which most employees are covered, require ten years for a worker to earn the nonforfeitable right to receive a pension. Due to their intermittent work patterns, millions of women each year do not meet that ten year requirement.

Integration

OWL supports measures to ensure that pensions are not lost or reduced to an amount below the poverty level due to practices of coordinating pensions with Social Security. This practice, called pension integration, is unfair because it takes away benefits from shorter service, lower-wage earners who are usually women and need pensions the most. Often employees' pensions are integrated without their understanding or knowledge, precluding accurate retirement planning.

Portability

OWL supports measures to aid workers in transferring vested pension credits to interest-bearing accounts or vehicles that secure the pension for retirement income upon termination of employment. Since women tend to be highly mobile workers because of dual careers in and outside of the home, it is important for women to have pension portability. Too often pensions are cashed out when leaving a job and used for purposes other than retirement because there is no vehicle with which to secure that pension. Under ERISA a pension plan may "cash out" the employee's vested pension without the employee's consent if it is under $3,500.

Coverage

OWL supports measures to increase the numbers of those covered under a pension plan. Specifically, we want to prohibit current practices that exclude certain groups of workers from participation in pension plans. Plans are currently allowed to exclude employees hired after age 60, part-time workers and certain classes of workers (often secretaries or clerical staff) from participation in the pension plan. Employers may also freeze a worker's pension benefit from accruing additional credit when he/she reaches 65 if that employee continues to work.

The impact of these practices amounts to legal age and sex discrimination. Women, particularly older women, are hurt by these practices because they -- more than their male counterparts -- are likely to be entering the job market late in life due to divorce or widowhood, and are likely to be secretaries or lower paid employees that may be excluded from plans.

Eradicating the barriers standing in the way of pension coverage for women is of key importance to OWL. Improvements in vesting, integration, and portability will only help a minority of women and men unless coverage is expanded as well.

OTHER RETIREMENT POLICY ISSUES

Pensions are not the only focus of older women's concern. An optimal national retirement policy should involve all sources of income, and must consider key health and long-term care questions as well.

Ideally, such a comprehensive plan ensures that all elderly Americans can meet their basic human needs with dignity, regardless of marital status, health, and past labor force participation.

At the present time, we have a piecemeal system of Social Security, private and public pensions, Supplemental Security Income, personal asset income, wages from continued employment, Medicare, and Medicaid. Even with improvements in poverty rates over the past twenty years, nearly one-fourth of elderly Americans live in or very near poverty, and women are disproportionately among them.

Many older persons would work if jobs and in some instances training or retraining were available; many cannot due to poor health. Still others who were in paid employment most of their adult lives find themselves with limited assets that are slowly eroded by inflation, out-of-pocket health care costs, and sometimes the catastrophic costs of institutionalized long-term care.

The fragmentary nature of current national retirement policy--illustrated by the array of Congressional committees with exclusive or overlapping jurisdiction over such programs as Social Security, public and private pensions, employee benefits, Medicare and Medicaid--precludes a wholistic approach.

While both men and women are caught in the resulting confusion, we believe that women are particularly effected. The following examples illustrate the schizophrenic nature of many individual public policies as they affect women.

- Increased health care costs motivate long-term care policy makers to find ways to encourage (or pressure) "families" to care for dependent elderly at home. Most frail elderly are not institutionalized, and receive care primarily from women--wives, daughters, sisters, neices, granddaughters. Little consideration is given to the impact that full-time caregiving will have on the future retirement income of these women, in the form of lost wages, pension benefits, and Social Security credits.

- Because Medicare helps to pay only for acute medical care, and Medicaid pays for custodial care but is only available to the poor, millions are dragged into poverty in old age. Most of them are women.

  Typically, a couple retires with what they think is an adequate income and and savings. Following the onset of an incapacitating illness and a period of caretaking at home, one spouse finally enters a nursing home as a private-pay resident. Within two years, a lifetime of savings has been consumed by nursing home bills; eligibility for Medicaid comes only when the couple is impoverished. After the death of a mate, the aged surviving spouse has no means of climbing out of poverty. Since 85% of surviving spouses over age 65 are female, it is evident that the absence of a comprehensive national long-term care policy disproportionately harms women and is a major retirement income concern.

- Recognizing that aged poor persons have little hope of changing their circumstances through employment, policy makers instituted SSI. Yet, even this program of last resort does not provide a minimum income at the poverty level. Further, since an extensive and on-going outreach effort is not required--is in fact opposed by many as a budget saving measure--millions of persons for whom the program was intended don't know it exists. (One study by the Social Security Administration showed that 80% of persons were eligible but not receiving SSI were women). And untold thousands are foregoing SSI as a source of much-needed income because the experience of applying for a "welfare" program brings such a sense of shame and failure.

- As the country's most successful social program, Social Security is a lifeline for women, both in protecting the family against loss of income through the death or disability of wage earners, and in providing retirement income. Yet the system has not kept up with major societal changes since 1940, especially increased divorce rates, and the dramatic entry of women into the labor force.

  The result is inadequacies in benefits and protections for some women and inequities for others. For example, divorced dependent spouses receive half the retirement benefit of their former spouses, which is completely inadequate; homemakers have no disability coverage. And millions of working women who pay FICA taxes for years receive no greater retirement benefit than if they had not been in paid employment because their benefit as workers is less than their benefit as dependent spouses.

- Current public policy strongly encourages Americans to remain in the paid labor force as long as possible. This is best illustrated in the 1983 Social Security Amendments that gradually raise the age of retirement with full benefits to age 67. Yet current policy and practice do not provide for adequate enforcement of laws prohibiting employment discrimination, do not mandate pension accrual after age 65, do not provide adequate job training/re-training and placement programs for older persons, and have not adequately addressed the problem of dependent care for the aged. Women have a unique stake in each of these issues.

It seems to us that taken together, these examples help to answer one of the key questions posed by the Subcommittee in holding these hearings. If the United States has a national retirement income policy, it is not clearly articulated and does not serve women well.

Further, major issues usually addressed as separate concerns must be understood and treated in a coordinated way. The Older Women's League believes that the following are essential components of a comprehensive national retirement policy.

- provision of minimum income for all; improvements in SSI benefits to at least the poverty level, with changes to protect part of the income and assets of a surviving spouse
- implementation of changes to make Social Security more adequate and equitable for women; earnings sharing seems to be the most promising means
- changes in private and public pension law to bring about shortened vesting time, repealed integration, greater portability, and increased coverage
- enforcement of laws prohibiting employment discrimination, with greater attention to multiple jeopardy (intertwined age/sex/race discrimination)
- the containment of health care costs and the development of a comprehensive long-term care policy

Thank you for the opportunity to share our views, and for your initiation of public discussion of these vitally important issues.

**PROFIT Sharing Council
Of America**
SUITE 722 20 NORTH WACKER DRIVE
CHICAGO ILLINOIS 60606 (312) 372 3411

STATEMENT OF THE PROFIT SHARING COUNCIL OF AMERICA TO THE HOUSE EDUCATION AND LABOR SUBCOMMITTEE ON LABOR-MANAGEMENT RELATIONS,
April 2 & 3, 1985

The Profit Sharing Council of America (PSCA) is a non-profit association of approximately 1,300 employers who maintain profit sharing plans. These plans cover approximately 1,750,000 employees. Council members are located throughout the United States and are engaged in practically all areas of economic activity. Member companies range in size from Fortune 500 size companies down to very small businesses.

Some of the material presented in this statement comes from the Profit Sharing Research Foundation (PSRF), Evanston IL, a non-profit publicly supported research and educational foundation.

Profit sharing is an incentive system and productivity booster whose design, application and approach differs according to the needs and problems of individual firms. When employees become profit conscious friction eases, production spurts, costs drop and profits rise. Profit sharing promotes and sustains morale, interest, allegiance and loyalty on the part of employees. When management intelligently shares profits the company prospers, the stockholders prosper, the employee prospers and the nation prospers. These factors should be kept in mind when considering legislation affecting such plans. Much of the emphasis we see today is geared to the retirement aspect of profit sharing alone, without due consideration of its contribution to the economic well-being of the nation.

Deferred profit sharing plans are or will be the primary private source of exceptional retirement benefits for millions of retirees and employees whose efforts during their working lifetimes contribute to the success of thousands of U.S. companies which elect to share their profits with their employees. There are approximately 360,000 deferred profit sharing plans in existence. These plans cover approximately 20 million employees and we estimate these plans have assets of well over $175 billion.

Profit sharing plans are usually established with one or more of the following objectives:

- to provide retirement income;
- to deliver benefits in the event of disability, death or employment termination prior to retirement;
- to create an incentive for increasing productivity and decreasing costs;
- to accumulate savings for employees, which contribute to capital formation; and

- to attract and reward employees by sharing the profits of the free enterprise system broadly throughout the organization.

Deferred profit sharing plans provide participating employees with special sums of money placed in trust, in addition to their pay at prevailing rates. These extra payments are based on the profits of the employer and generally average 8% to 10% of payroll, but can range up to 15%. In recent years employees savings in plans have dramatically increased through voluntary and mandatory employee contributions and through cash or deferred arrangements under Section 401(k).

A large majority of plans offer options to participants as to how and when their accumulated profit sharing accounts are distributed at retirement. Generally the account is distributed in a lump sum. Many plans also allow the retirees to receive their account balances in annual installments or the plan may purchase and distribute an annuity contract. If the participant dies while employed, the full account balance is distributed to the designated beneficiaries, regardless of service requirements for vesting. Some plans permit partial withdrawals or loans during employment, in hardship situations. Plans usually provide for limitations on partial withdrawals and loans to prevent the participant's retirement security from being jeopardized.

A number of profit sharing plans also invest in stock of the employer. In this way the employee not only shares in the profits of his employer, but is also given a proprietary interest in the success of his employer. In this way the employees are made true partners in the employer's business. This stock is often distributed to employees at retirement and permits them flexibility in meeting their retirement needs.

One of the chief objectives of most profit sharing plans is to provide an accumulation of retirement capital for the employee and not necessarily a form of fixed annuity income. This capital makes it possible for retired employees to maintain the flexibility needed to meet changing conditions during their retirement years. For example, in addition to providing retirement living expenses, a profit sharing lump sum payment allows the retired employee to pay off the mortgage on a home, to move to a more favorable climate and purchase a retirement home, to have the funds for costly medical care and to make investments to maintain the level of his economic security in retirement.

We have witnessed the debilitating effects of inflation. We have seen that a more than adequate pension, as judged by standards 25 years ago, will not even meet today's test for determining the poverty level. We believe it is most unfair to force an employee to receive his profit sharing accumulations in an annuity or a similar fixed type of periodic retirement payment and thereby subject these funds to the eroding effect of inflation and depreciation in the purchasing power of the dollar. A lump sum payment gives the employee the flexibility to protect himself or herself against this risk.

Those who object to allowing participants to receive a lump sum seem to have no confidence in the ability of the American worker to handle his or her own funds in retirement. In the Council's many years of experience the great majority of participants in profit sharing plans want and take lump sum distributions and we have never heard of one instance in which a lump sum given at retirement has been squandered by the participant. If such events were to occur, I am sure that Council members would see to it that profit sharing payments were made on an installment basis since they, too, are concerned with the needs of their retiring employees.

Profit sharing is a superior mechanism for delivering enriching financial benefits to participants in every level of the American economic structure. This is possible because of the following facts, which are characteristic of virtually all profit sharing plans.

- Increased profits produce increased retirement income potential, thus enabling each individual to enhance his or her future security.
- Immediate or speedy vesting common in profit sharing creates early non-forfeitable benefits which become the building blocks of economic independence.
- Fast vesting and lump sum distributions permit employees who don't retire to continue retirement-security building programs by rolling account balances into Individual Retirement Accounts or retirement programs of new employers.
- Departing members' forfeitures are spread among remaining participants; very rarely are they used to reduce employer contributions.
- Participants -- never the plan sponsor -- receive the fruits of successful investment of plan assets. Because the participant is "at risk" many plans offer investment options that permit each person to select the fund which offers the elements which most appeal to him or her at each decision-making time.
- Profit sharing plans that are "integrated" with Social Security are extremely rare. This means that profit sharing benefits to lower-paid participants are not reduced by an amount related to the expected Social Security benefit.
- Terminated plan assets go fully vested to participants. None revert to the employer. Nor is there any involvement of the Pension Benefit Guaranty Corporation.
- Regardless of age or service, accounts of profit sharing participants who die vest fully and are delivered promptly to beneficiaries, usually in the form desired. Disability also brings unqualified full vesting.

- Most plans now permit participants to further enhance their future security by contributing their own money to their account through payroll deduction. Two additional advantages result: "free" professional management of these savings and tax deferral on the earnings generated.

- Variety of distribution options at retirement (lump sum, installment, annuity) plus rollover capability to IRA, give maximum flexibility for each individual to utilize the method best suited to his or her own needs.

- Favorable taxation at distribution (or further tax deferral on rollovers) means that maximum net proceeds are available for meeting each person's retirement financial requirements.

- Because the retiree upon distribution owns and controls the assets, he or she has unlimited opportunity to take steps to offset the inroads of inflation, pay off the mortgage, move to a retirement residence, or otherwise exercise judgment in matters relating to one's own well being.

We believe that the advantages cited will continue to provide superior economic security to American workers covered by profit sharing plans.

Some objections have been raised to the ability of plan participants to withdraw voluntary savings in profit sharing plans. However, if these withdrawals are prohibited or severely restricted, participants -- particularly younger participants -- will tend not to save, thus diminishing the pool of savings which can be used for retirement in future years. The fact that some of these withdrawals may be used for non-retirement purposes is no reason for eliminating the withdrawals and thereby discouraging younger employees from saving through their profit sharing plan.

We believe that the unique benefits to be derived from profit sharing should not be sacrificed to patronizing zeal in protecting the employee by prescribing still another uniform annuity system and restricting the ability of the American worker to handle his or her own money in a way he or she determines suitable.

Profit Sharing Council of America

Walter Holan
President

Rudd and Wisdom, Inc.
CONSULTING ACTUARIES

7718 WOOD HOLLOW DRIVE
SUITE 100
AUSTIN, TEXAS 78731
512/346-1590

PHILIP S. DIAL, F.S.A.
CHARLES V. FAERBER, F.S.A.
MARK R. FENLAW, F.S.A.
MARK S. FRANCE, F.S.A.
LESLEE S. HARDY, A.S.A.
DAVID HUFF, F.S.A.
ROBERT M. MAY, F.S.A.
J. CHRISTOPHER McCAUL, A.S.A.
MICHAEL J. MUTH, A.S.A.
RONALD W. TOBLEMAN, F.S.A.
EUGENE WISDOM, F.S.A.

May 2, 1985

The Honorable William L. Clay
Subcommittee on Labor-Management Relations
2451 Rayburn House Office Building
Washington, D.C. 20515

Re: National Retirement Policy

Dear Representative Clay:

I am writing to you about the Subcommittee on Labor-Management Relations activity in the attempt to formulate a legislative national retirement policy.

I am a consulting actuary and work extensively with retirement programs that are sponsored by both private and public sector employers. It is my involvement with qualified retirement programs and other areas of employee benefits that provide me with the following opinions that I would like to share with your Subcommittee:

1. Continuous legislative changes and the resulting modifications in regulatory requirements are having a very negative impact on smaller employers that attempt to sponsor qualified retirement plans. Most large corporations can absorb the administrative costs inherent with the recent onslaught of regulatory change but many smaller employers are terminating current retirement plans to escape the increasing administrative burdens associated with sponsoring a qualified plan. I have more and more employers ask the question: "Why should I put up with the headaches and constant change of a qualified plan that covers all employees when, for example, I can install a non-qualified deferred compensation plan for a few high paid, key employees and still get tax advantages by funding with "minimum deposit" life insurance policies?" In short, the incentives to sponsor retirement programs by many employers are being overwhelmed by the administrative costs and complications at the ultimate expense of rank and file workers. Stability in the retirement legislative and regulatory environment must be established.

2. Qualified (tax-favored) retirement plans should be used as retirement plans first and only secondarily as pure deferred compensation programs. For example, I view profit sharing plans as severance pay plans, not as retirement plans. Profit sharing plans can provide very attractive benefits to employees but, in their current use, they are only incidentally functioning as retirement benefit plans. If any revenue raising measures require that Congress look to curtailments in qualified plan benefits, I urge that profit sharing plans (i.e. tax deferred compensation programs) be curtailed first before any limitations in basic pension programs are enacted.

3. IRC 401(k) plans are very popular types of profit sharing plans that, in my opinion, are being marketed and utilized not as long term retirement programs but simply as income tax deferral programs. Individual savings towards retirement should continue to be encouraged and possibly expanded through the IRA medium but employer sponsored 401(k) plans are, in my opinion, bad national retirement policy especially in light of current federal deficits. At the very least, inservice distributions and loan availability from 401(k) plans should be discontinued. All retirement programs should take steps to ensure that benefits provided are payable throughout the retirement years and not all at once at termination of employment.

4. A single administrative agency should be appointed to oversee the operation of any national retirement policy which is enacted. A single agency would be better positioned to simplify the existing network of regulators (IRS, DOL, PBGC, etc.) and should be commissioned to aggressively seek ways to simplify administrative burdens for employers while maintaining a proper regulatory environment.

I am excited that your Subcommittee has opened testimony on the establishment of a national retirement policy as the existing patchwork quilt of today is not a policy but is a happenstance. I appreciate your time in reading this letter and I wish your Subcommittee success in its venture. If I can provide you or members of your staff with any clarification of my opinions or if I can be of any assistance in your work, please do not hesitate to contact me.

I have enclosed several copies of this letter in hope that you might circulate it among the other members of your Subcommittee.

Sincerely,

Ronald W. Tobleman, F.S.A.

RWT:tc

Enclosures

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

April 24, 1985

Honorable William L. Clay
Chairman
Committee on Education and Labor
Subcommittee on Labor-Management Relations
U. S. House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

Thank you for the opportunity to present my views on the development of a national retirement income policy. As Chief Counsel for Advocacy of the U. S. Small Business Administration, I am authorized to represent the views and interests of small business before Federal agencies and the Congress. It is in that capacity that I am requesting that my comments be included in the record of the hearings on retirement income policy held on March 21, April 2, and April 3, 1985.

Small businesses employ approximately 47% of the private sector work force and in recent years have contributed over half of the new jobs to our economy.[1] Because the cost, the flexibility and the administration of retirement benefits can affect this contribution by the small business sector, it is important to consider the impact of a retirement policy on small employers.

The development of a national retirement income policy that encompasses Social Security, private pensions and personal savings is an important concern of small business. Small businesses are striving to compete with large businesses in providing employees with pension coverage. In addition, small businesses shoulder a significant portion of the Social Security payroll tax burden. In devising any retirement income policy, it is necessary to recognize the position of small business in the economy, and in the employee benefits arena, and ensure that small businesses' interests are encompassed in any retirement income policy.

---

[1] U. S. Business Administration, The State of Small Business: A Report of the President, (Washington, D. C.: U. S. Government Printing Office, March 1984), Chapter. 1

1. Small Businesses Require Maximum Flexibility to Establish and Maintain Employee Benefit Plans

In developing a national retirement income policy, it is important to provide small business with the widest possible latitude to establish and maintain employee benefit plans. Small business contributes most to the economy when permitted to operate freely and respond to changing market influences.

Both during the 1981-1982 recession, and the continuing recovery, small firms have created more new jobs and innovations than large business.[2] The vitality and adaptability of small firms ensures that they will lead the way in growing sectors of the economy, enabling our economy to keep pace with others around the world.

Government policies can promote or inhibit the diversity and energy of millions of entrepreneurs. Policies in the areas of tax, regulation, and access to capital all affect small firm formation and growth very directly. Similarly, the adoption of any rigid criteria in the retirement income area would inhibit small business' ability to compete and, ultimately, would jeopardize small business workers' retirement income security. As discussed in more detail in the following section, small businesses have greater difficulty than large firms in providing pension benefits and require incentives to initiate plans, rather than additional barriers.

As a consequence, I do not believe that a single policy for retirement benefits, including Social Security, private pensions and personal savings, should be devised and labelled a "national retirement income policy." Imposition of such uniformity on the millions of businesses in the country would affect the ability of small firms to test new markets, develop new products and, ultimately, produce the very jobs and benefits that would be the aim of a "national retirement income policy."

---

[2] During the 1981-1982 recession, small firms created 2.6 million new jobs, more than offsetting the 1.7 million jobs lost by large corporations during that period. During the recent recovery, small businesses created an estimated five million of the approximately seven million new jobs. In addition, research conducted for the Office of Advocacy shows that small firms produce 2.5 times as many innovations as large firms, relative to the number of people employed. See Gelman Research Associates, Inc., "The Relationship Between Industrial Concentration, Firm Size and Technological Innovation," May 1982.

If, on the other hand, a "national retirement income policy" were to simply mean that greater consideration be given to the interaction of the several areas of Social Security, private pensions and personal savings, then I believe the effort would indeed be worthwhile. Agreed-upon goals for the several areas of retirement policy are important to assure that laws and programs do not work at cross purposes. To assist in the development of such goals, in the following sections I am providing information that focuses on the employee benefits plans of small firms.

2. A Significant Goal of a National Retirement Income Policy Must Be To Expand Pension Coverage in Small Businesses

The Social Security system was established to provide a "floor" of retirement income. Employer provided pensions provide an essential supplement to this basic income. Currently, however, nearly 60 percent of retirees rely exclusively on Social Security income to finance retirement.[3] To lessen reliance on the Social Security system, an important goal of a national retirement income policy must be to expand private pension coverage, particularly in small businesses.

Research indicates that pension coverage increases with firm size (Table 1). In 1983, 18.7 percent of workers in firms with under 25 employees were offered pension coverage, as compared to 40.7 percent in firms with 25-99 employees, 63.6 percent in firms with 100-499 employees, and 86.2 percent in firms with over 500 workers.[4] Given the substantial level of pension coverage already achieved in large firms, any significant expansion of worker coverage will occur in small businesses, particularly in those with fewer than 100 employees.

To increase pension coverage in small firms, it is necessary to understand why many small businesses do not currently have pension plans. A study conducted for the Office of Advocacy reveals that the primary reason that small businesses do not establish benefit plans is because the firms lack sufficient profitability to direct funds to pensions.[5] Small businesses not only lack the funds necessary to initiate the administration and funding of plans, but often lack sufficient profits to benefit from the tax deductibility of employer contributions to qualified plans. The current system of tax deductible contributions to qualified plans and income tax deferral on funds by employees provides incentives to employers to establish benefit plans. The removal of any of the current tax incentives to maintain employee benefit plans would substantially lessen the likelihood of small business pension plan formation.

---

[3] Testimony of the Honorable John Heinz, Chairman Special Committee on Aging, U. S. Senate, on "The Need for a National Retirement Income Policy," before the subcommittee on Labor-Management Relations, Committee on Education and Labor, U. S. House of Representatives, April 2, 1985.

[4] Source: U. S. Department of Commerce, Bureau of the Census, Current Population Survey, May 1983, unpublished data.

Other reasons for the lower pension coverage in small firms are the high administrative costs and regulatory complexities associated with maintaining plans. The administrative costs of pension plans tend to be relatively fixed; small businesses are unable to take advantage of scale economies and end up paying more than large businesses in administrative costs per employee. For example, research indicates that it costs the smallest firms (with 1-10 employees) $1,080 per employee to establish a pension plan as compared to $574 per employee in firms with 500-999 workers.[6] There is evidence that government regulation contributes to increased administrative costs. One study revealed that the Employee Retirement Income Security Act of 1974 (ERISA) increased administrative costs for small plans with less than 100 participants by 72 percent.[7]

Small employers have also cited the frequent changes in the relevant law as a significant impediment to the establishment of a pension plan.[8] Even more than the laws' inherent complexities, the constant regulatory and legal changes trouble small employers. New laws affecting employee benefit plans were enacted in 1981, 1982, and 1984. Not only does the changing legal climate significantly increase administrative costs, as plans must be brought into compliance, it creates uncertainties about the future and the potential costs of maintaining benefit plans. An essential element of a national retirement income policy must be the goal of less frequent changes in the law or, at the very least, more lead-time for compliance. Administrative burdens could be substantially lessened if businesses were given a period of time to comply with all of the new requirements that were established within a given period.

---

[5] James Bell and Associates, "Coverage, Characteristics Administration and Costs of Pension and Health Care Benefits in Small Businesses" (Washington, D. C.: U. S. Small Business Administration, award no. SBA-6059-OA-82, March 1984); hereafter, "Pension and Health Care Benefits."

[6] Ibid.

[7] U. S. Department of Labor, Assessment of the Impact of ERISA on the Administrative Costs of Small Retirement Plans, prepared by Price Waterhouse & Co., (Washington, D. C. 1977).

[8] Bell, "Pension and Health Care Benefits."

To significantly increase pension coverage for retirees, efforts must be made to decrease the start-up and administrative costs of small employers' pension plans. In addition to slowing the pace of new legislation affecting benefit plans, current incentives to establish defined contribution plans should be maintained, if not enhanced. As discussed in more detail below, defined contribution plans tend to be simpler and cheaper than defined benefit plans and offer the only viable retirement plan options for the overwhelming majority of small employers.

3. A Retirement Income Policy Must Recognize the Importance of Defined Contribution Plans to Small Business

Defined contribution plans are far more prevalent than defined benefit plans in small firms. In defined benefit plans, workers are promised a specific level of benefits, while in defined contribution plans employers promise to make annual contributions to workers' accounts. Contributions in defined contribution plans are usually based upon a percentage of profits or payroll; workers are entitled to the vested portion of their account balances upon retirement, death, disability or the termination of employment.[9]

---

[9] The term "vested" refers to the right to pension benefits that cannot be revoked by the employer, even upon the termination of employment. Employees attain vested rights to portions of and sometimes all accrued benefits after satisfying specific service or service and age requirements. ERISA specifies three different vesting formulas. In defined contribution plans, an employee's individual account reflects employer/employee contributions, investment gains and losses, and sometimes the forfeited account balances of employees who left the employment before fully vesting.

While defined contribution plans are also popular in large firms, often as a second, or even third plan, they are likely to be the small firm's only retirement income vehicle. Of firms having pension plans in 1982, 73 percent of firms with fewer than 25 employees and 67 percent of firms with 25 to 99 employees had only defined contribution plans; this is compared to 7 percent of firms with 100 or more workers.[10] Small businesses (with less than 100 employees) are most likely to have profit-sharing plans as the single employee benefit plan; they rarely have established Employee Stock Ownership Plans or 401(k)s.[11]

Defined contribution plans are prevalent in small firms because they are cheaper, easier, and have more certain costs than defined benefit plans. In defined contribution plans, it is not generally necessary to accrue benefits for workers for years of service prior to the plan's inception. This can significantly minimize the start-up costs of a pension plan. Defined contribution plan sponsors need not rely on complex actuarial computations to estimate future benefits and appropriate funding, as in defined benefit plans. This lessens recordkeeping burdens and administrative costs. Moreover, employers' payments to defined contribution plans are certain: for example, a percentage of profits, as in a profit-sharing plan, or a percentage of payroll, as in a money purchase pension plan. The employer bears no risk of poorly invested assets, nor potential liability to the Pension Benefit Guarantee Corporation, as in defined benefit plans. The certainty of costs and simplicity of plan administration are major reasons why small businesses adopt defined contribution plans, if they provide workers with retirement benefits at all.

Defined contribution plans are also appropriate for small businesses because of the composition of the small business work force. Small businesses tend to hire more part-time workers, seasonal workers, women, first-job holders, and older workers than large businesses. Defined contribution plans are appropriate to meet the needs of this constantly changing work force. Benefits tend to vest faster, are more portable,[12] and employers' financial and administrative obligations can be limited to the length of the worker's employment. Because defined contribution plans typically "cash out" employees in a lump sum upon the termination of employment, employers are freed from funding benefits and keeping records for workers who have long since left the employment and are well into their retirement. Defined benefit plans, on the other hand, generally have delayed vesting, less portability, and assume long-term relationships between employers and employees. Because benefits are usually paid to retirees monthly in defined benefit plans, employers' funding and administrative obligations can continue well beyond the termination of employment.

---

[10] Bell, "Pension and Health Care Benefits."

[11] 401(k) plans are named after that section of the Internal Revenue Code which permits employees to defer from current taxation the lower of 15 percent or $30,000 of salary which is contributed to a qualified plan. Both employers and employees may make contributions to the plan.

A number of pension industry observers have attacked defined contribution plans because they permit lump sum distributions upon the termination of employment. It is asserted that this feature, as well as defined contribution plans' early withdrawal provisions, make tax-favored savings funds available to employees prior to retirement. There is growing evidence that employees who receive lump sum distributions spend the money rather than reinvest it other retirement savings plans.[13]

In efforts to discourage the use of tax-deferred savings for nonretirement purposes, it is important not to alter the basic design of defined contribution plans nor create disincentives to their establishment. Policymakers must distinguish what employees do with the funds from the needs of employers to adopt defined contribution plans. The ability of an employer to "cash out" a worker when he or she leaves the job is a very important feature of defined contribution plans to small employers. If small employers were required to keep workers on the books for years after they left the job, so that these workers could be paid their benefits during retirement, the plans' administrative costs and burdens would be so significant that small firms would drop or never initiate benefit plans. This would result in an even greater reliance on Social Security income during retirement. In devising a retirement income policy that promotes security for workers, it is important to recognize the economic realities of employers and carefully tailor limitations to pre-retirement use of the funds, without inadvertently raising barriers to plan formation.

---

[12] Portability is the ability to transfer vested pension benefit credits to a succeeding plan or Individual Retirement Account (IRA) on the termination of employment. This feature is beneficial for workers entitled to benefits under several employers' plans.

[13] Employee Benefit Research Institute, EBRI Issue Brief, #34, September, 1984.

Small business wants to keep pace with large business in providing employee benefits and attracting a quality work force. To achieve greater pension coverage in small firms, however, it is necessary to permit small business maximum flexibility to operate in the economy and provide it with a variety of reasonable options in the adoption and maintenance of employee benefit plans.

Very truly yours,

Frank S. Swain
Chief Counsel for Advocacy

VIN WEBER
2d District, Minnesota

318 Cannon Building
Washington, D.C. 20515
(202) 225-2131

LEONARD SWINEHART
Administrative Assistant

P.O. Box 279
New Ulm, Minnesota 56073
(507) 354-6400

919 South 1st Street
Willmar, Minnesota 56201

P.O. Box 1214
Marshall, Minnesota 56258
(507) 532-9611

JACK MEEKS
District Director

Congress of the United States
House of Representatives
Washington, D.C. 20515

COMMITTEE ON PUBLIC WORKS
AND TRANSPORTATION

SUBCOMMITTEES
WATER RESOURCES
AVIATION

COMMITTEE ON SMALL BUSINESS

SUBCOMMITTEE
ANTITRUST AND RESTRAINT
OF TRADE

ASSISTANT REGIONAL WHIP
REPUBLICAN POLICY COMMITTEE

April 1, 1985

Mr. Russ Mueller
Labor Management Relations Subcommittee
Committee of Education and Labor
2101 Rayburn House Office Building
Washington D.C. 20515

Dear Russ,

Thank you for the information about the Oversight Hearings on pension reform scheduled for April 2 and 3. I notified my constituents about these hearings.

Several of my constituents sent letters to me and asked that they be submitted to the committee. I have enclosed these letters for your review and ask that they be submitted as testimony at the Oversight Hearings.

Please keep my office informed about future hearings about pension reform. You can reach Terri Ashmore of my staff at (612) 235-6820.

Thank you for your consideration of this request and your assistance with helping me respond to my constituents.

Sincerely,

VIN WEBER
Member of Congress

ENC
VW/tha

Dear Congressman Vin Weber

I have contributed to the CLA Pension Fund for 8 yrs. and was 2 yrs from vesting. In 1981 the employees voted to decertify and I was unable to complete my vesting. the problem I have is my money and time are lost. This is unfair. the solution is to force the union to allow portability of my funds so I can move the monies contributed on my behalf to something like an IRA. Please accept this information as testimony for the April 2 and 3 hearings.

thank you

APR 1 1985

Sincerely
Gary A. Slagter

GARY A. SLAGTER
BOX 243
DANUBE, MN 56230

Harvey Roelofs
R#1 Box 88
Prinsburg, Mn
56281

March 30, 1985

Congressman Vin Weber
919 South 1st Street
Willmar, Mn. 56201

Dear Mr Vin Weber

I was a member of Christian Labor association for 25 years. During this time we started + Paid into a Pension for 12 yrs so I became Vested. In 1981 the employees of our Company Voted to decertify from the C.L.A. and so now my Pension benifits are Frozen at #11. Per service Unit until my retirement date. each year they are increasing in Value but these increases are going to the Active members. I believe that our benifits should also be increased or our monies should be Portable in that we could turn them over into an I.R.A.

Thank you for hearing my Problem

Sincerely
Harvey Roelofs

APR 1 1985

3-29-85

Congressman Vin Weber,

I am writing in regards to a problem that I and alot of my fellow employees are experiencing.

I work for a contractor in the road construction industry, have been since 1971. When I started working, we were represented by the Christian Labor Assn. In 1981, the employees voted to decertify and drop the union. I ended up paying into the CLA Pension Fund from 1971-1981. and at the time we decertified I had 9.8 credit years. Therefore, all my time and money paid in was lost. You must have 10 credit years to be vested. I feel this is very unfair and would like to see some sort of Legislation passed that would make this money transferable to some other type of pension plan.

I understand that there will be a hearing on the 2nd and 3rd of April that will be addressing this subject. Mr. Weber, please accept this information as testimony for this hearing.

Rodney Hendrickson

Rodney Hendrickson
809 No. 7th St.
Montevideo, MN.
56265

APR 1 1985

810 South 12th Street
Montevideo, Minnesota
56265

Mr. Vin Weber
919 South 1st Street
Willmar, Minnesota
56201

Dear Mr. Weber:

I am writing you about my Christian Labor Association pension fund; while working for Duininck Brothers & Gilchrist in 1981, and being a member of CLA, the men joined in a strike which failed.

The only way we could go back to work for DB&G was without the union. Because of the labor situations at this time, the men were forced to vote out the union.

Having 11 years in the union, and 10 years of Vesting, my pension was froze at the previous years money arrangement. This was $11.00 per service unit.

Now, being that all the monies that the men from DB&G contributed were frozen, the union Raised the remaining members unit credit to $23.00 per service unit. As you must see, this is not fair.

We are looking for help to change this legislation that is protecting the union from being fair to us. The union should be forced to increase these frozen credit monies, or make them transferrable, so we could work with the pension money to assure our future. Now the law protects primarily the union, not the members that pay for the future pension.

I am asking you to please help us start some legislation that will credit the injustice we are facing. Could you speak up for us on the April 2nd and 3rd hearing on pension reform?

I, and many other employees would be willing to help you in any way possible. Thank you for your time, and I hope to hear from you very soon.

Sincerely yours,

Paul Janke

Paul E Janke

APR 2 1985

Dear Congressman Weiss; March 29, 1985

I am writing this letter about the C.L.A. (Christian Labor Association) Pension Fund. In 1981 the employees of Duininck Bros. + Gilchrist voted to decertify the C.L.A. This left me unable to complete my vesting.

The Problem is that all of my time spent, (either 4 or five years) I'm not sure exactly how long, and the money Invested are now lost. This is not fair or right. Feel free to use this information as testimony in the hearing on April 2-3.

I see the solution to this problem is to force the C.L.A. to free the funds received on my behalf, So that I could use the funds for something on the order of an IRA.

Thank-you

Sincerely,

Garry Duininck

Duininck Bros. + Gilchrist

Garry Duininck
907 W. 3rd street
Willmar Minn.
56201

From Bradley Gort
732 No. 3rd
Montevideo MN. 56265

to:
Mr. Russ Mueller
Committee on Education + Labor
U. S. House of Representatives
2451 Rayburn HOB
Washington, D.C.

I would like to ask you for help and to accept this information as testimony for the April 2nd & 3rd hearings.

I worked for Duininck Bros + Gilchrist for 12 years and in 1981 they refused to sign a contract with our C.I.A. union.

I was only 2 weeks away from having 10 years in with the union and I would have been vested. Duininks Bros + Gilchrist wouldn't sign the contract so I lost all my money that I had put in my retirement plan.

I would like any help that you can offer or else all the time and money will be lost and I believe this to be unfair.

Any help or advise you may have will be deeply appreciated.

Thank you
Yours Truly
Bradley Gort

March 30, 1985

Wallace A. Carlson
Rt. # 2 Box 732
New London, Minn. 56273

Mr. Russ Mueller
Committee on Education & Labor
United States House of Representives
2451 Rayburn HOB
Washington, D.C. 20515

Dear Mr. Mueller;

I was a member of the Christian Labor Ass'n. Union for 24 years. This Union has its main office in Grand Rapids, Mich.

In 1981 our local went on strike. The Company involved would not agree to the union demands and in order to work for this Company we voted to decertify from the C.L.A. With this decertification my pension funds were frozen.

Currently the pension fund has raised the dollar amount applied to the credit years of service from $11.00 to 23.00 per service unit. Even though the Union continues to earn interest on the monies contributed on my behalf, because I am an inactive member my pension amount, if I should attain retirement age, are frozen at the $11.00 amount. I think this is unfair.

In the past 4 years since I have been inactive, this Union doesn't even send we inactive members a financial statement on where the're investing this money. I have phoned and asked for a financial statement and they haven't sent one.

The solution to this problem in my estimation is to pay me the increased benefit otherwise make my portion of monies in the pension fund portable so that I could invest this money in an IRA or the like.

Would you please accept this information as testimony for the April 2 and April 3 hearings.

Sincerely,

Wallace A. Carlson

Wallace Carlson

To Mr. Russ Mueller
Re: Pension Programs
March 30, 1985

Mr. Mueller

I am asking for your help. I belong to a pension program that is no longer working in my behalf.

I belonged to a union that had a pension program. In 1981 the employees of our company Voted to decertify the Christian Labor Association Union, at which time our pension benefits were frozen in the program. I am Vested in the program. The pension fund has raised the dollar amount applied to the credit years of service from $11 to $23 per service unit. This is only for those still active in the union. I think that it is unfair that the C.L.A. pension program can continue to earn interest on money contributed to the program on my behalf. There is no way I will benefit from the interest that they are earning.

Is there a way that union can be forced to pay those Vested people either a portion of or all the interest that they are earning? Another solution would be to make our portion of the pension fund portable. This money could then be invested in IRA's or the like.

Mr. Mueller, [illegible]

WEAL
Women's Equity Action League

Specialists in Women's Economic Issues

Testimony by

Women's Equity Action League

Submitted to

THE U.S. HOUSE OF REPRESENTATIVES

Committee on Education and Labor

Subcommittee on Labor-Management Relations

For the hearings on

A NATIONAL RETIREMENT INCOME POLICY

Hearings held April 3, 1985

1250 I Street NW, Suite 305, Washington, DC 20005 (202) 898-1588

Representative Clay, members of the Subcommittee on Labor-Management Relations, the Women's Equity Action League (WEAL) would like to thank you for the opportunity to submit testimony to your committee. WEAL specializes in issues of economic equity and has been particulary concerned with economic issues affecting women and their retirement equity. The importance of a national retirement income policy has long since been recognized by WEAL. Pension reform and earnings sharing under Social Security are two aspects of retirement with which WEAL is especially concerned.

A woman's situation upon retirement is a culmination of events that have transpired throughout her life. For many years a woman will work at discriminatorily low wages outside of the home or spend her most productive years at home, supporting and caring for a husband and children as her contribution to the family prosperity. Unfortunately, pensions and retirement systems do not recognize the nature of women's work lives nor do they provide adequate security and protection for spouses in recognition of their share in the family's earnings.

Women have been helped by private pension reforms beginning in 1974 when Congress enacted the Employment Retirement Income Security Act (ERISA). This was the first law passed to provide comprehensive protection for workers covered by private pension plans. The next step occurred in 1982 with the passage of the Tax Equity and Fiscal Responsibility Act (TEFRA). A provision of this act requires "topheavy" plans (plans established to reward high income and long term workers) to spread pension benefits more equitably, especially to "non-key" workers who are

mostly women. The most recent legislation regulating private pension plans was passed in 1984, the Retirement Equity Act (REA). This legislation strengthens provisions of ERISA, and helps widows and younger workers of both sexes. ERISA, TEFRA and REA are all steps toward a fair and equitable retirement policy. However, these sensible and just laws do not address all of the basic flaws in the current pension system. Five fundamental problems still remain in the present system, problems which work to deny pension protection to a large number of workers, most of them women.

First, under current law, the vast majority of workers covered by private pension plans must work ten years for the same employer to fulfill the vesting schedule and attain "vested status". According to the Bureau of Labor Statistics (BLS), 87 percent of the full-time employees in large and medium size firms participate in plans with ten year vesting rules. Unfortunately, women are less likely then men to meet these lengthy service requirements. In 1983, men working full-time spent an average of 5.1 years with their current employer, while women spent only 3.7 years. In 1979, Brandeis University prepared a projectory study for the Department of Labor, and predicted that 6.7 million workers covered by private pension plans would change jobs between 1980-1982 and that 2/3's of these workers would forfeit service time accrued under their plan by changing jobs. Reform which recognizes America's mobile workforce by requiring a maximum of five year vesting, instead of ten, would benefit both women and men.

Second, those who work long enough to qualify frequently find that their pension is worth far less than they expected becausé current law permits plans to take Social Security payments into account when calculating private pension benefits. This practice, called Social Security integration, can virtually eliminate the entire benefit a low-income worker would otherwise be entitled to receive under the plan. According to the Bureau of Labor Statistics, 55 percent of the full-time employees in large and medium size firms are participating in integrated pension plans. Fully or partially eliminating integration is an essential equity reform.

Third, our pension system makes it extremely difficult to transfer vested credits from one plan to another. Because the average length of time spent with the current employer is less for women than for men, these regulations impact more heavily on women. When a worker with vested pension rights changes jobs, the benefits are often frozen leaving stagnated money, unable to increase from the time the worker leaves that job until retirement. As a result, the worker who changes jobs several times and earns a pension at each job will have to live on a much lower pension income than if these seperate amounts could be transferred to a portable pension account where the worker could accrue years worked cumulatively and the pension account could continue to earn interest until retirement. The situation is even worse for employees who never achieve vested status. They may work a total of forty years, but having never stayed at one job long enough to complete the vesting schedule they have no pension at all. Most "withdraw" their own contributions to a pension fund and fail to invest it in retirement savings.

Fourth, twenty-one years after the passage of Title VII and after several Supreme Court decisions which make it perfectly clear that employers may not use sex-segregated actuarial tables to compute employee contributions and benefits, many pension plans still pay women smaller benefits than their male colleagues who have worked the same number of years for the same salaries. Women who buy individual annuities with life insurance or lump sum retirement benefits face reduced monthly payments as well.

Lack of coverage is the fifth and largest problem our current pension system faces today. Many solutions have been offered to counter this problem. Tax deductions available to employers who provide pension plans is the current incentive to prod employers into establishing plans. The cost of these "tax shelters" was recently estimated at $47,245,000,000 for FY 1984. Yet only 56.1 percent of the full-time labor force is covered by a pension plan.

Our present private pension system allows the exclusion of workers who: are over the age of 65, begin work within five years of the normal retirement age, have been employed less than a year, or work fewer than 1000 hours a year (half-time). These exclusions combined with vesting requirements may account for the low percentage of people covered by pensions.

Especially hurt by these exclusions are part-time workers. Coverage for part-time work must be considered relevent to any reform of our nation's retirement income purposes.

* The part-time labor force comprises 14%

of our nation's civilan labor force.

- 11 million part-time workers are women.
- The median income for women part-time workers is $2,756.
- 60% of all women part-time workers, including those with and without pension plans available in their work place, do not meet ERISA criteria.

Furthermore, the majority (3/5's) of women part-time workers have over one year of service on the job. And approximately 21% have a tenure history of five or more years. Clearly, the notion that all part-time employees work for short, inconsequential periods of time is inaccurate.

Older workers are also hurt by these exclusions. In 1983, 7.8 percent of the women over 65 and 17.9 percent of the men over 65 continue to work full-time. Unfortunately, even if they were participants in a pension plan, vested or not, they received no further credits for these additional years of work. If they began work at the age of 60 and the retirement age was 65, they were excluded from participating in the company's plan.

Another basic problem with women's pensions is not addressed by any pension reform; full-time women workers still earn only a little over sixty percent of what full-time men workers earn. Until this wage gap is closed, women's pension will always be less then men's.

Complementary to the problems women workers face with the present private pension system are the problems faced by

homemakers. Neither Social Security nor private pension plans are based on a concept of earnings sharing which would give adequate recognition to a homemaker's economic contribution to the family unit. Widows and divorced spouses are frequently left little or no protection from the nation's public and private retirement systems.
(attachment: Earnings Sharing: Equity and Adequacy for Women Under Social Security.)

The "Not-So-Golden" Years

Retirement-age women face severe economic problems, whether they have worked outside or within the home. The receipt of a pension - earned from their own work experience or that of their spouse - is crucial to the financial security of older women. Yet too often the law fails to enable them to receive the pension they have "earned".

* 59 percent of all persons 65 and older were women in 1983.
* Only 11.5 percent of the 15.5 million women 65 and older received benefits from a private pension in 1983; 29.9 percent of the 10.9 million men 65 and older received benefits.
* For those women receiving a pension, the average pension income was $2,634. Men received $4,491.

- The median annual income for older women from all sources (savings, pension, social security) was $5,599. For men it was $9,766.
- Single women (widowed, divorced, or never married) constitute 80% of elderly women living below the poverty line.

Conclusions

Reform in the areas of vesting, integration, portability and coverage are positive steps towards securing a national income retirement policy. All Americans will benefit from these reforms and the nation will be "richer" for them. Thank you for considering this important issue and heeding WEAL's concerns.

WEAL Facts

Women's Equity Action League
1250 I Street NW, Suite 305, Washington, DC 20005 (202) 898-1588

EARNINGS SHARING:

Equity and Adequacy for Women Under Social Security

What Is Earnings Sharing?

Earnings sharing is a concept which would reform the Social Security system by treating marriage as an economic partnership. Earnings sharing would base Social Security benefits on earnings records shared equally between spouses for each year of marriage, plus individual earnings before and after marriage. Upon death of a spouse, the survivor would inherit the earnings credits of the deceased spouse.

Earnings sharing would provide each person with an individual earnings record as a worker -- even if some or all of the work was unpaid homemaking. For example, each partner in a one-earner couple with monthly earnings of $800 would receive credit for $400 in earnings. Similarly, partners in a couple with two wage-earners would each be credited with half of their total combined earnings. In this way, the economic contribution that each partner makes to a marriage would be recognized.

Why Do We Need Earnings Sharing?

The present Social Security system was crafted fifty years ago when women were viewed primarily as homemakers in lifelong marriages. Family structures are more varied and divorce is more common today. Most women combine homemaking and paid work during their lives, yet women are penalized for doing this.

Social Security laws are the same for women and men, but the system pays highest benefits to highly-paid workers with continuous employment -- typically men. Women receive less protection: lifetime low wages and zeros averaged into wage records for time spent out of the workforce in homemaking responsibilities lower women's Social Security benefits and result in their having little or no disability coverage. More than twice as many men as women receive disabled worker benefits, and their benefits are, on average, 40% higher.

In December 1984, retired female workers received an average monthly benefit of $396 compared to $518 for male workers. Disabled women workers received $371 compared to $519 for disabled men workers. Elderly widows receiving survivor benefits averaged $416, and divorced women receiving spouse benefits averaged only $240. The Social Security system has been a lifeline for elderly women, but half of the 8.4 million single elderly women receiving benefits live at or near the poverty level.

Earnings sharing would provide better protection for divorced, widowed and disabled women and would make the Social Security system fairer for two-earner couples.

HOW COULD EARNINGS SHARING IMPROVE SOCIAL SECURITY FOR WOMEN AND THEIR FAMILIES?

Married Couples

Current Law: Social Security provides a dependent spouse benefit that is 50% of the amount of the worker's benefit. A two-earner couple with the same lifetime average earnings as a one-earner couple may receive a smaller retirement check because the one-earner couple also receives the 50% spouse benefit.

Earnings Sharing: One-earner couples would no longer receive the additional spouse benefit. Retired couples in lifelong marriages who have paid Social Security taxes on the same total earnings would receive equivalent benefits.

Married Women

Current Law: A married woman may receive a worker benefit on her own wage record. Lifetime low earnings and time spent out of the labor force in dependent and home care cause many women to receive a worker benefit so low that they receive more as a dependent spouse. Other women receive a worker benefit only slightly higher than they would receive as a spouse. The retirement benefit these women receive does not reflect their economic contribution to the marriage and the Social Security taxes they paid.

Earnings Sharing: Married people who spend time out of the labor force would receive wage record credits based upon their spouse's earnings. Thus, women would carry Social Security protection with them as they moved between the labor market and unpaid work in the home. Families of deceased or disabled homemakers could receive benefits based on credits accumulated during marriage.

Divorced Women

Current Law: If her marriage lasted ten or more years, a divorced woman may receive the same 50% dependent spouse benefit that a wife receives. This low supplementary benefit is inadequate to maintain a separate household. Even if she receives a benefit solely on her own work record, the amount may be quite low due to years of no or low earnings during time spent in home and dependent care.

Earnings Sharing: The ten-year marriage requirement would be eliminated. Upon divorce, each spouse would receive credits based on the total earnings of the couple during the period of the marriage. Divorced women would thus have an earnings record to build on in the labor market.

Widowed Women

Current Law: An elderly surviving spouse receives 100% of the deceased worker's benefit unless her own worker benefit is higher. The larger the portion of the couples' earnings that was earned by the deceased worker, the higher the survivor benefit. Thus, in couples with the same average lifetime earnings, the survivor of the two-earner couple usually receives a much lower benefit than the survivor of the one-earner couple. Elderly widows are likely to have no other sources of retirement income, even when they have worked for pay. A widow may also risk poverty during the "widow's gap" -- the period between the time her last child reaches age 16 and the time she becomes eligible for reduced widow's benefits at age 60.

Earnings Sharing: A widow would inherit the total earnings credits accumulated by the couple during a marriage and could add them to her own earnings credits. The inequity between survivors of couples would be eliminated. Widows of two-earner lifelong marriages would benefit greatly from earnings sharing, while other widows such as those who have brief marriages and low earnings would not. Earnings sharing plans could address the "widow's gap" by providing an adjustment allowance to help a widow enter the workforce so that she could become economically self-sufficient and build Social Security credits for retirement.

Disabled Women

Current Law: Disability benefits are paid only if the person qualifies as a worker and has been in the labor force for 5 of the 10 years prior to disability. Women who take time out of the workforce for dependent care often have no disability protection or, if they do, receive low disability benefits because of low wage records. Lifelong homemakers are not even eligible to apply for disability benefits unless they are widowed. Disabled women who qualify as widows may receive retirement benefits at age 50, but they must pass a much more stringent "disability test" than workers. The families of these disabled women may experience severe economic hardship.

Earnings Sharing: Married, widowed and divorced women would have their own earnings record based upon wages from employment and shared or inherited earnings credits from marriage. Disability benefits would be determined on the basis of that record, regardless of age or labor force participation. Earnings sharing would expand disability protection for women as well as increase their disability benefits.

What are the Features of a Good Earnings Sharing Plan?

There are many ways to design an earnings sharing plan. While all earnings sharing plans treat marriage as a partnership, they may differ in transitional benefits, implementation plans, effects and costs. Additional costs to the system should not deter from ensuring adequate and equitable Social Security benefits.

WEAL believes a good earnings sharing plan must contain the following features:

- mandatory sharing
- a carefully crafted transition to the new system to protect people with expectations based on the current system
- measures to assure adequate benefit levels
- elimination of the 10-year marriage requirement for divorced persons
- 100% inheritance of earnings credits for survivors
- eligibility for disability benefits at any age
- an adequate adjustment benefit to help widows enter the workforce

A plan incorporating the above features has been designed by the Technical Committee on Social Security Reform for Women, a nongovernmental group of experts and advocates in which WEAL plays a leading role. The Technical Committee's final report will be available late in spring of 1985.

What Is the Status of Earnings Sharing In Congress?

Comprehensive earnings sharing legislation -- H.R. 158, H.R. 191 and S. 3 -- has been introduced in the 99th Congress respectively by Rep. Mary Rose Oakar (D-OH); Rep. Robert Roe (D-NJ); and Sen. Alan Cranston (D-CA). All bills are presently pending in the House Committee on Ways and Means.

In 1983 Congress directed the Department of Health and Human Services to issue a report on earnings sharing. Released in January 1985, the HHS report substantiates the inequities and inadequacies women face in the current system and shows how earnings sharing can help. The report, however, fails to fulfill its congressional mandate to develop earnings sharing legislative proposals and to include recommendations for implementation, transition provisions and, if necessary, adequate protection for particular classes of beneficiaries.

FOR MORE INFORMATION ON SOCIAL SECURITY AND OTHER WOMEN'S ISSUES, WRITE FOR A FREE PUBLICATIONS LIST TO: WEAL, 1250 "Eye" Street, Washington, D.C. 20005.

Contact: Maxine Forman, Director of Policy Analysis
Patricia Blau Reuss, Legislative Director

Written by: Jody M. Foster, March 1985.
Contents may be reproduced provided credit is given to WEAL. Sources available upon request.

STATE OF MARYLAND

HARRY HUGHES
GOVERNOR

DOMINIC N. FORNARO
COMMISSIONER

DEPARTMENT OF LICENSING AND REGULATION
DIVISION OF LABOR AND INDUSTRY
501 ST. PAUL PLACE · BALTIMORE, MARYLAND 21202-2272
301/659-4179

FREDERICK L. DEWBERRY
SECRETARY

NANCY B. BURKHEIMER
DEPUTY COMMISSIONER

June 13, 1985

Honorable William Clay, Chairman
Subcommittee on Labor-Management Relations
United States House of Representatives
2451 Rayburn House Office Building
Washington, D. C. 20515

Dear Congressman Clay:

I am writing to you in my official capacity as Commissioner of Labor and Industry for Maryland to request your assistance and support in amending and clarifying the Employee Retirement Income Security Act of 1974 (ERISA).

Maryland, as well as a majority of other states, administers laws requiring the enforcement of the payment of wages to employees as promised by the employer. These states' wage payment and collection laws apply to wages in the form of payroll benefits, such as holiday pay, vacation pay, sick pay and severance pay.

With the enactment of ERISA for the purpose of regulating employee benefit plans, ERISA defined employee welfare benefits as including many of the same benefits covered by state wage payment laws. Also the law superseded "any and all state laws insofar as they may now or hereafter relate to any employee benefit plan."

Due to the preemption provision, many employers throughout the country are challenging the viability of state laws and making it impossible for state administrators to enforce state laws. Courts have ruled in several cases that ERISA preempts state laws in the enforcement of such benefits as vacation and severance pay.

The result of these decisions has been that employees in those states have become less well protected by law when seeking to recover promised wage benefits. Not only do employees lose the assistance of state administrative agencies in collecting their pay, but increasingly courts are applying a less strict standard of liability against employers under ERISA than had been applied under state laws.

BALTIMORE METRO AREA 659-4179
OUTSIDE BALTIMORE METRO AREA
TOLL-FREE 1-800-492-6226

TTY FOR DEAF
BALTO. AREA 383-7555
D.C. METRO 565-0451

It is clear from the expression of legislative intent that ERISA was intended to increase protection of employees with respect to their benefits. Insofar as the courts' broad interpretation of ERISA's preemptive effect is creating the opposite result, an amendment to ERISA is appropriate to reverse the effects of these decisions and restore Congressional intent.

At its annual convention in Tulsa, Oklahoma during the week of July 8, 1984, the National Association of Governmental Labor Officials (NAGLO), of which I am a member, adopted a resolution proposing the following amendment to ERISA:

> An act to amend and clarify ERISA by adding a second and third sentence to Section 514(a), 29 U.S.C. §1144(a):
>
> State laws prohibiting employers from discriminating in the provision of employee benefits, obligating employers to pay promised employee welfare benefits to its employees, and providing for the enforcement of such obligations shall not be considered laws relating to an employee benefit plan. The foregoing sentence shall not apply to employee pension benefit plans.

I am requesting your support in the adoption of this amendment.

Thanking you in advance for your consideration of my request.

Sincerely,

Dominic N. Fornaro

Dominic N. Fornaro
Commissioner of Labor
and Industry

DNF:pje

Enclosure

NAGLO RESOLUTION

ERISA AMENDMENT

Submitted by John C. Brooks
Commissioner of Labor, State of North Carolina

WHEREAS, the majority of states have laws requiring and enforcing the payment of wages promised by employers; and

WHEREAS, the majority of state wage payment laws apply to wages in the form of one or more of the following employee benefits, to wit, vacation holiday pay, sick pay, severance pay or other similar benefits promised by employers; and

WHEREAS, the United States Congress has enacted the Employee Retirement Income Security Act of 1974 (ERISA) which regulates, among other things, employee welfare benefit plans; and

WHEREAS, an employee welfare benefit is defined in ERISA as including many of the same benefits covered by state wage payment laws, to wit, vacation pay, holiday pay, sick pay, severance pay and other similar benefits; and

WHEREAS, ERISA by its own terms supersedes "any and all state laws insofar as they may now or hereafter relate to any employee benefit plan;" and

WHEREAS, the United States Supreme Court has held in the case of Shaw v. Delta Airlines, Inc., _____ U. S. _____, 103 S. CT. 2890 (1983) that "Congress used the words 'relate to' . . . in their broadest sense" and that a law "relates to" an employee benefit plan "if it has a connection with or reference to such a plan;" and

WHEREAS, states are uniquely qualified and able vis-a-vis the federal government to enforce wage payments and, thus protect their working citizens;

NOW THEREFORE BE IT RESOLVED BY THE NATIONAL ASSOCIATION OF GOVERNMENTAL LABOR OFFICIALS IN ITS 67TH ANNUAL CONVENTION ASSEMBLED IN TULSA, OKLAHOMA DURING THE WEEK OF JULY 8, 1984,

That the Association does hereby request and recommend to the United States Congress that it adopt the Amendment, set out below, to the Employee Retirement Income Security Act:

"An Act to amend and clarify ERISA by adding a second and thrid sentence to section 514(a), 29 U.S.C. §1144(a):

State laws prohibiting employers from discriminating in the provision of employee benefits, obligating employers to pay promised employee welfare benefits to its employees and providing for the enforcement of such obligations shall not be considered laws relating to an employee benefit plan. The foregoing sentence shall not apply to employee pension benefit plans."

Be it further resolved that a copy of this amendment be sent to the President, the Secretary of Labor, and to all members of Congress at their convening in 1985.